

## HIGHLIGHTS OF THIS ISSUE

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

### INCOME TAX

#### **T.D. 9672, page 196.**

TD 9672 includes final Treasury regulations providing guidance under section 45R of the Internal Revenue Code, as added by the Patient Protection and Affordable Care Act. Section 45R generally provides a tax credit to certain small employers that offer health insurance coverage to their employees. The regulations affect small employers, both taxable and tax-exempt, that are or might be eligible for the tax credit.

### EMPLOYEE PLANS

#### **T.D. 9673, page 212.**

This document contains final regulations relating to the use of longevity annuity contracts in tax-qualified defined contribution plans under section 401(a) of the Internal Revenue Code (Code), section 403(b) plans, individual retirement annuities and accounts (IRAs) under section 408, and eligible governmental plans under section 457(b). These regulations will provide the public with guidance necessary to comply with the required minimum distribution rules under section 401(a)(9) applicable to an IRA or a plan that holds a longevity annuity contract. The regulations will affect individuals for whom a longevity annuity contract is purchased under these plans and IRAs (and their beneficiaries), sponsors and administrators of these plans, trustees and custodians of these plans and IRAs, and insurance companies that issue longevity annuity contracts under these plans and IRAs.

### EXEMPT ORGANIZATIONS

#### **T.D. 9674, page 225.**

This document contains regulations that provide guidance to eligible organizations seeking recognition of tax-exempt status under section 501(c)(3). The regulations amend current regulations to allow the Commissioner to adopt a streamlined application process that eligible organizations may use to apply for recognition of tax-exempt status under section 501(c)(3).

#### **REG-110948-14, page 239.**

This document contains regulations that provide guidance to eligible organizations seeking recognition of tax-exempt status under section 501(c)(3). The regulations amend current regulations to allow the Commissioner to adopt a streamlined application process that eligible organizations may use to apply for recognition of tax-exempt status under section 501(c)(3). Comments requested by September 30, 2014.

#### **Rev. Proc. 2014-40, page 229.**

This revenue procedure sets forth procedures for applying for and for issuing determination letters on the exempt status under section 501(c)(3) of the Internal Revenue Code using Form 1023-EZ, *Streamlined Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code*. This revenue procedure is generally available for certain U.S. organizations with assets of \$250,000 or less and annual gross receipts of \$50,000 or less. This revenue procedure amplifies Rev. Proc. 2014-9, Rev. Proc. 2014-10, Rev. Proc. 2014-4, Rev. Proc. 2014-5, and Rev. Proc. 2014-11; and supplements Rev. Proc. 2014-8. This revenue procedure is effective July 1, 2014.

Finding Lists begin on page ii.  
Index for July through July begins on page iv.

# The IRS Mission

Provide America's taxpayers top-quality service by helping them understand and meet their tax responsibilities and enforce the law with integrity and fairness to all.

## Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned

against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

### **Part I.—1986 Code.**

This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1986.

### **Part II.—Treaties and Tax Legislation.**

This part is divided into two subparts as follows: Subpart A, Tax Conventions and Other Related Items, and Subpart B, Legislation and Related Committee Reports.

### **Part III.—Administrative, Procedural, and Miscellaneous.**

To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts. Also included in this part are Bank Secrecy Act Administrative Rulings. Bank Secrecy Act Administrative Rulings are issued by the Department of the Treasury's Office of the Assistant Secretary (Enforcement).

### **Part IV.—Items of General Interest.**

This part includes notices of proposed rulemakings, disbarment and suspension lists, and announcements.

The last Bulletin for each month includes a cumulative index for the matters published during the preceding months. These monthly indexes are cumulated on a semiannual basis, and are published in the last Bulletin of each semiannual period.

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# Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

## Section 45R.—Employee health insurance expenses of small employers

26 CFR 1.45R-0 Tax credit to certain small employers that provide insured health coverage to their employees.

### TD 9672

#### DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

#### Tax Credit for Employee Health Insurance Expenses of Small Employers

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations on the tax credit available to certain small employers that offer health insurance coverage to their employees. The credit is provided under section 45R of the Internal Revenue Code (Code), enacted by the Patient Protection and Affordable Care Act. These regulations affect small employers, both taxable and tax-exempt that are or might be eligible for the tax credit.

DATES: Effective Date: These regulations are effective on June 30, 2014.

*Applicability Dates:* For dates of applicability, see 1.45R-1(b), 1.45R-2(g), 1.45R-3(j), 1.45R-4(g) and 1.45R-5(c).

FOR FURTHER INFORMATION CONTACT: Stephanie Caden, (202) 317-6846 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

#### Background

Section 45R of the Code offers a tax credit to certain small employers that provide insured health coverage to their employees. Section 45R was added to the Code by section 1421 of the Patient Pro-

tection and Affordable Care Act, enacted March 23, 2010, Public Law No. 111-148 (as amended by section 10105(e) of the Patient Protection and Affordable Care Act, which was amended by the Health Care and Education Reconciliation Act of 2010, Public Law 111-152 (124 Stat. 1029)) (collectively, the “Affordable Care Act”).

Section 45R(a) provides a health insurance credit that is available to certain eligible small employers for any taxable year in the credit period. Section 45R(d) provides that in order to be an eligible small employer with respect to any taxable year, an employer must have in effect a contribution arrangement that qualifies under section 45R(d)(4) and must have no more than 25 full-time equivalent employees (FTEs), and the average annual wages of its FTEs must not exceed an amount equal to twice the dollar amount determined under section 45R(d)(3)(B). The amount determined under section 45R(d)(3)(B) is \$25,000 (a dollar amount which is adjusted for inflation for taxable years beginning after December 31, 2013, and is \$25,400 for taxable years beginning in 2014).

Section 45R(d)(4) provides that a contribution arrangement qualifies if it requires an eligible small employer to make a nonelective contribution on behalf of each employee who enrolls in a qualified health plan (QHP) offered to employees by the employer through an Exchange in an amount equal to a uniform percentage (not less than 50 percent) of the premium cost of the QHP (referred to in this preamble as the uniform percentage requirement). For purposes of section 45R, an Exchange refers to a Small Business Health Options Program (SHOP) Exchange, established pursuant to section 1311 of the Affordable Care Act and defined in 45 CFR 155.20. For purposes of this preamble and the final regulations, a contribution arrangement that meets these requirements is referred to as a “qualifying arrangement.”

Section 45R(b) provides that, subject to the reductions described in section 45R(c), the amount of the credit is equal

to 50 percent (35 percent in the case of a tax-exempt eligible small employer) of the lesser of (1) the aggregate amount of nonelective contributions the employer made on behalf of its employees during the taxable year under the qualifying arrangement for premiums for QHPs offered by the employer to its employees through a SHOP Exchange, or (2) the aggregate amount of nonelective contributions the employer would have made during the taxable year under the arrangement if each employee for which a contribution would be taken into account under clause (1) of this sentence had enrolled in a QHP which had a premium equal to the average premium (as determined by the Secretary of Health and Human Services) for the small group market in the rating area in which the employee enrolls for coverage.

Section 45R(c) phases out the credit based upon the number of the employer’s FTEs in excess of 10 and the amount by which the average annual wages exceeds \$25,000 (a dollar amount which is adjusted for inflation for taxable years beginning after December 31, 2013, and is \$25,400 for taxable years beginning in 2014). Specifically, section 45R(c) provides that the credit amount determined under section 45R(b) is reduced (but not below zero) by the sum of: (1) the credit amount determined under section 45R(b) multiplied by a fraction, the numerator of which is the total number of FTEs of the employer in excess of 10 and the denominator of which is 15, and (2) the credit amount determined under section 45R(b) multiplied by a fraction, the numerator of which is the average annual wages of the employer in excess of the dollar amount in effect under section 45R(d)(3)(B) and the denominator of which is that dollar amount. Section 45R(d)(3) provides that the average annual wages of an eligible small employer for any taxable year is the amount determined by dividing the aggregate amount of wages that were paid by the employer to employees during the taxable year by the number of FTEs of the employer and rounding that amount to the next lowest multiple of \$1,000.

Section 45R(e)(2) provides that for taxable years beginning in or after 2014, the credit period means the two-consecutive-taxable year period beginning with the first taxable year in which the employer (or any predecessor) offers one or more QHPs to its employees through a SHOP Exchange.

For taxable years beginning in 2010, 2011, 2012, and 2013, section 45R(g) provides that the credit is determined without regard to whether the taxable year is in a credit period, and no credit period is treated as beginning with a taxable year beginning before 2014. The maximum amount of the credit for those years is 35 percent (25 percent in the case of a tax-exempt eligible small employer) of an eligible small employer's nonelective contributions for premiums paid for health insurance coverage (within the meaning of section 9832(b)(1)) of an employee. Section 45R(g)(3) provides that an employer does not become ineligible for the tax credit for years beginning prior to 2014 solely because it arranges for the offering of insurance outside of a SHOP Exchange.

In 2010, the Treasury Department and the IRS published two notices addressing the application of section 45R that taxpayers may rely upon for taxable years beginning before 2014: (1) Notice 2010-44 (2010-22 IRB 717 (June 1, 2010)) (addressing the eligibility requirements and how to calculate and claim the credit, and providing transition relief for taxable years beginning in 2010 with respect to qualifying arrangements); and Notice 2010-82 (2010-51 IRB 857 (December 20, 2010)) (expanding guidance on the eligibility requirements, the uniform percentage requirement, and the application of the average premium cap).

On August 26, 2013, the Treasury Department and the IRS released a notice of proposed rulemaking (REG-113792-13, 78 FR 52719) to provide guidance on the application of section 45R for years beginning on or after January 1, 2014. The section of the preamble to these proposed regulations entitled "Proposed Effective/Applicability Dates" provided that employers may rely on the proposed regula-

tions for guidance for taxable years beginning after 2013 and before 2015. Fourteen comments responded to the notice of proposed rulemaking; no public hearing was requested or held. After consideration of all of the comments, these final regulations adopt the provisions of the proposed regulations with certain modifications, the most significant of which are highlighted in the Explanation and Summary of Comments below. All comments are available for public inspection at [www.regulations.gov](http://www.regulations.gov) or upon request.

The Treasury Department and the IRS issued Notice 2014-6 (2014-2 IRB 279 (January 6, 2014)), which provides transition relief for certain small employers that cannot offer a QHP through a SHOP Exchange because the employer's principal business address is in a particular listed county in which a QHP will not be available through a SHOP Exchange for the 2014 calendar year.

## **Explanation and Summary of Comments**

### *I. In general*

The proposed regulations and these final regulations generally incorporate the provisions of Notice 2010-44 and Notice 2010-82 as modified to reflect the differences between the statutory provisions applicable to years beginning before 2014 and those applicable to years beginning after 2013. As in Notice 2010-44 and Notice 2010-82, the proposed and final regulations use the term "qualifying arrangement" to describe an arrangement under which an eligible small employer pays premiums for each employee enrolled in health insurance coverage offered by the employer in an amount equal to a uniform percentage (not less than 50 percent) of the premium cost of the coverage. Section 45R(d)(4) also requires that, for taxable years beginning in or after 2014, the health insurance coverage described in a qualifying arrangement be a QHP offered by an employer to its employees through a SHOP Exchange (subject to certain transition guidance for 2014). The final regulations generally re-

tain these provisions and definitions. The final regulations also add definitions for the term "tobacco surcharge," which refers to the surcharge in addition to the premium that may be charged in the SHOP Exchange that is attributable to tobacco use, and for the term "wellness program," which refers to a program under which discounts or rebates are offered for employee participation in programs promoting health. These definitions incorporate terms found in 45 CFR 147.102(a) of the final regulations for Health Insurance Market Rules, issued on February 27, 2013 (78 FR 13406), and § 54.9802-1(f) of the final regulations on Incentives for Nondiscriminatory Wellness Programs in Group Health Plans, issued on June 3, 2013 (78 FR 33157).

### *II. Eligibility for the Credit*

Consistent with section 45R and the proposed regulations, these final regulations define an eligible small employer as an employer that has no more than 25 FTEs for the taxable year, whose employees have average annual wages of no more than \$50,000 per FTE (as adjusted for inflation for years after 2013), and that has a qualifying arrangement in effect that requires the employer to pay a uniform percentage (not less than 50 percent) of the premium cost of a QHP offered by the employer to its employees through a SHOP Exchange.<sup>1</sup> These regulations define a tax-exempt eligible small employer as an eligible small employer that is described in section 501(c) and that is exempt from tax under section 501(a). These regulations also provide that all employers treated as a single employer under section 414(b), (c), (m), or (o) are treated as a single employer for purposes of section 45R.

Consistent with the proposed regulations, these final regulations further provide that employees (determined under the common law standard) who perform services for the employer during the taxable year generally are taken into account in determining FTEs and average annual wages. In determining FTEs, these regulations provide that FTEs are calculated

<sup>1</sup>Although the term, "eligible small employer" is defined in section 45R(d)(1) to include employers with "no more than 25 FTEs," the phase out of the credit amount under section 45R(c) operates in such a way that an employer with exactly 25 FTEs is not in fact eligible for the credit.

by computing the total hours of service for the taxable year (using one of three allowable methods) and dividing by 2,080. If the result is not a whole number, the result is rounded down to the next lowest whole number, except if the result is less than one the employer rounds up to one FTE. One commenter requested that the FTE calculation include only full-time employees who work 40 hours a week and not part-time employees. The final regulations do not adopt this suggestion because it is inconsistent with the statutory definition of full-time equivalent employee set forth in section 45R(d)(2). These final regulations provide that leased employees, as defined in section 414(n)(2), are counted in computing a service recipient's FTEs and average annual wages. See section 45R(e)(1)(B). These regulations also provide that premiums paid on behalf of a former employee may be treated as paid on behalf of an employee for purposes of calculating the credit provided that if so treated, the former employee is also treated as an employee for purposes of the uniform percentage requirement. See § 1.45R-1(a)(5)(vii).

Consistent with the proposed regulations, these final regulations provide that an employee's hours of service for a year include hours for which the employee is paid, or entitled to payment, for the performance of duties for the employer during the employer's taxable year and provide three methods for calculating the total number of hours of service for employees for the taxable year. One commenter requested that employees of educational organizations be credited with hours of service during employment breaks because the use of a 12-month measurement period for employees who provide services only during the active portions of the academic year could inappropriately result in these employees not being treated as full-time employees. The final regulations do not adopt this suggestion because it is inconsistent with the statutory framework of section 45R, which bases calculations on FTEs, not full-time employees.

Wages, for purposes of the credit, are defined in these final regulations (and the proposed regulations) as amounts treated as wages under section 3121(a) for purposes of FICA, determined without con-

sidering the social security wage base limitation. To calculate average annual FTE wages, an employer must determine the total wages paid during the taxable year to all employees, divide the total wages paid by the number of FTEs, and if the result is not a multiple of \$1,000, round the result to the next lowest multiple of \$1,000. One commenter requested that the final regulations clarify whether bonuses are included in the average annual wage calculation. The proposed and these final regulations provide that the average annual wage limitation is determined using the definition of wages found in section 3121(a), determined without regard to the social security wage base limitation under section 3121(a)(1); therefore, bonuses would be included to the extent treated as wages under section 3121(a) for purposes of FICA.

Based on section 45R(d)(5), the proposed regulations and these final regulations provide that employees who work on a seasonal basis for 120 or fewer days during the taxable year are not considered employees when determining FTEs and average annual wages, but premiums paid on behalf of seasonal workers may be counted in determining the amount of the credit. One commenter requested clarification of whether all employees who terminate employment before working 120 days are considered seasonal employees for purposes of the FTE calculation. The final regulations, like the proposed regulations, provide that only workers who perform labor or services on a seasonal basis, including retail workers employed exclusively during holiday seasons, meet the definition of a seasonal worker for purposes of the credit. The final regulations further provide that employers may apply a reasonable, good faith interpretation of the term seasonal worker and a reasonable good faith interpretation of 29 CFR 500.20(s)(1) (including as applied by analogy to workers and employment positions not otherwise covered under 29 CFR 500.20(s)(1)).

### III. *Calculating the Credit*

Under section 45R and these final regulations, for taxable years beginning in or after 2014, the maximum credit for an eligible small employer other than a tax-

exempt eligible small employer is 50 percent of the eligible small employer's premium payments made on behalf of its employees under a qualifying arrangement for QHPs offered through a SHOP Exchange. For a tax-exempt eligible small employer for those years, the maximum credit is 35 percent.

As provided in the proposed regulations, for purposes of calculating the credit under section 45R for taxable years beginning after 2013, the final regulations provide that an employer's premium payments are limited by the average premium in the small group market in the rating area in which the employee enrolls for coverage through a SHOP Exchange. The credit will be reduced by the excess of the credit calculated using the employer's premium payments over the credit calculated using the average premium. For example, if an employer pays 50 percent of the \$7,000 premium for employee coverage (\$3,500), but the average premium for employee coverage in the small group market in the rating area in which the employees enroll is \$6,000, for purposes of calculating the credit the employer's premium payments are limited to 50 percent of \$6,000 (\$3,000).

Under section 45R and the proposed regulations, the credit phases out for eligible small employers if the number of FTEs exceeds 10, or if the average annual wages for FTEs exceed \$25,000 (as adjusted for inflation for taxable years beginning after 2013). For an employer with both more than 10 FTEs and average annual FTE wages exceeding \$25,000, the credit is reduced based on the sum of the two reductions. This may reduce the credit to zero even for some employers with fewer than 25 FTEs and average annual FTE wages of less than double the \$25,000 dollar amount (as adjusted for inflation). These final regulations incorporate these statutory phase-out provisions, and also retain the provisions pertaining to state subsidies and tax credit limitations.

With respect to the payroll tax limitation for tax-exempt employers, section 45R and the proposed regulations defined the term "payroll taxes" as (1) amounts required to be withheld under section

3402<sup>2</sup> and (2) the employee's and employer's shares of Medicare tax required to be withheld and paid under sections 3101(b) and 3111(b) on employees' wages for the year. For a tax-exempt eligible small employer, the amount of the credit cannot exceed the amount of the payroll taxes of the employer during the calendar year in which the taxable year begins. The final regulations retain these provisions.

Consistent with the proposed regulations, these final regulations provide that the first year for which an eligible small employer files Form 8941, "Credit for Small Employer Health Insurance Premiums," claiming the credit, or files Form 990-T, "Exempt Organization Business Income Tax Return," with an attached Form 8941, is the first year of the two-consecutive-taxable year credit period. Even if the employer is eligible to claim the credit for only part of the first year, the filing of Form 8941 begins the first year of the two-consecutive-taxable year credit period, regardless of when the employer begins offering QHPs through a SHOP. A commenter noted that the two-year limit on the credit period might cause some employers to discontinue contributing to coverage once the credit expires after two years. However, the statutory language imposes the limitation and the final regulations incorporate these provisions of the proposed regulations pertaining to the two-consecutive-taxable year credit period limitation.

In general, only premiums paid by the employer for employees enrolled in a QHP offered through a SHOP Exchange are counted when calculating the credit. A stand-alone dental health plan offered through a SHOP Exchange will be considered a QHP for purposes of the credit. See Patient Protection and Affordable Care Act; Establishment of Exchanges and Qualified Health Plans; Exchange Standards for Employers, 77 Fed. Reg. 18310, 18315 (March 27, 2012).

Consistent with the proposed regulations, these final regulations provide that amounts made available by an employer under, or contributed by an employer to, Health Reimbursement Arrangements

(HRAs), health flexible spending arrangements (FSAs), and health savings accounts (HSAs) are not taken into account for purposes of determining premium payments by the employer when calculating the credit. One commenter requested that household employers be allowed to claim the credit through use of an HRA. The final regulations do not adopt this modification. An employer's premium payments are not taken into account for purposes of the section 45R credit unless they are paid for health insurance coverage under a qualifying arrangement, which is an arrangement under which the employer pays premiums for each employee enrolled in health insurance coverage offered by the employer in an amount equal to a uniform percentage (not less than 50 percent) of the premium cost of the coverage. For taxable years beginning in or after 2014, generally an employer must make premium payments on behalf of its employees for QHPs offered by the employer to its employees through a SHOP. Because an HRA is a self-insured plan, this type of arrangement is not health insurance coverage for purposes of the credit and employer contributions to this type of arrangement are not taken into account for purposes of the credit for any year.

Also, consistent with the proposed regulations, the final regulations provide that a minister who is a common law employee is taken into account in an employer's FTE calculation and the premiums paid by the employer for health insurance for the minister may be counted in calculating the credit.

With respect to trusts, estates, regulated investment companies, real estate investment trusts, and cooperative organizations, section 45R(e)(5)(B) provides that rules similar to the rules of section 52(c), (d), and (e) will apply. Because section 45R(f) explicitly provides that a tax-exempt eligible small employer may be eligible for the credit, these regulations do not adopt a rule similar to section 52(c) but do provide that rules similar to the rules of section 52(d) and (e) and the regulations thereunder apply in calculating and apportioning the credit with respect to these entities.

If an eligible small employer's plan year begins on a date other than the first day of its taxable year, it may not be practical or possible for the employer to offer insurance to its employees through a SHOP Exchange at the beginning of its first taxable year beginning in 2014. The proposed regulations provided a transition rule that applies if (1) as of August 26, 2013, an eligible small employer offers coverage in a plan year that begins on a date other than the first day of its taxable year, (2) the employer offers coverage during the period before the first day of the plan year beginning in 2014 that would have qualified the employer for the credit under the rules otherwise applicable to the period before January 1, 2014, and (3) the employer begins offering coverage through a SHOP Exchange as of the first day of its plan year that begins in 2014. Under the transition rule, the small employer will be treated as offering coverage through a SHOP Exchange for its entire 2014 taxable year for purposes of eligibility for, and calculation of, a credit under section 45R. Thus, for an employer that meets these requirements, the credit will be calculated at the 50 percent rate (35 percent rate for tax-exempt eligible small employers) for the entire 2014 taxable year and the 2014 taxable year will be the start of the two-consecutive-taxable year credit period. One commenter requested that this transition rule apply to all employers that have plan years that do not match their taxable years, including those that changed plan years after August 26, 2013, and that it should not be limited to those employers having a plan year that does not match the taxable year as of August 26, 2013. However, the intent of the rule was to provide relief for employers that had plan years that did not match their taxable years when the proposed regulations were issued and not to provide a mechanism to change plan years to maximize the credit without satisfying the statutory requirements. Accordingly, the final regulations include without change the transition rule set forth in the proposed regulations.

Several commenters requested the credit be made available to eligible small

<sup>2</sup>Although section 45R(f)(3)(A)(i) cites to section 3401(a)(1) as imposing the obligation on employers to withhold income tax from employees, it is actually section 3402 that imposes the withholding obligation. We have cited to section 3402 throughout this preamble and in the proposed and these final regulations.

employers if a SHOP Exchange is not available in the employer's principal place of business for the 2014 calendar year. Treasury and the IRS issued Notice 2014-6 to address these concerns with respect to eligible small employers with a principal business address in counties (listed in the Notice) in which no qualified health plans are available through a SHOP Exchange for 2014.<sup>3</sup> For purposes of the transition rule provided in the final regulations for an eligible small employer with a group health plan year that begins on a date in 2014 other than the first day of the employer's taxable year, an employer with a principal business address in one of the counties listed in Notice 2014-6 is not required to begin offering coverage through a SHOP Exchange as of the first day of its plan year that begins in 2014 in order to be treated as offering coverage through a SHOP Exchange for its entire 2014 year. Instead, such an employer is required to continue offering health insurance coverage for the plan year that begins in 2014 that would have qualified for a tax credit under section 45R under the rules applicable before 2014.

In accordance with Notice 2014-6, small employers described in the preceding paragraph may calculate the credit by treating health insurance coverage provided for the 2014 health plan year as qualifying for the section 45R credit, provided that the coverage would have qualified for a credit under section 45R under the rules applicable before 2014. This treatment applies with respect to the health plan year beginning in 2014, including any portion of that plan year that continues into 2015. If the eligible small employer claims the section 45R credit for the 2014 taxable year, the credit will be calculated at the 50 percent rate (35 percent rate for tax-exempt eligible small employers) for the entire 2014 taxable year, and the 2014 taxable year will be the first year of the two-consecutive-taxable-year credit period. In addition, if the eligible small employer claims the section 45R credit for the portion of the 2014 health plan year that continues into 2015, the tax credit will be calculated at the 50 percent

rate (35 percent rate for tax-exempt eligible small employers) for the corresponding portion of the 2015 taxable year.

### III. Application of Uniform Percentage Requirement

#### A. Uniform premium

Section 45R requires that to be eligible for the credit, a small employer must generally pay a uniform percentage (not less than 50 percent) of the premium for each employee enrolled in a QHP offered to its employees through a SHOP Exchange. The proposed regulations set forth requirements for applying this requirement in separate situations depending upon (1) whether the premium established for the QHP is based upon list billing or is based upon composite billing, (2) whether the QHP offers only employee-only coverage, or other tiers of coverage, such as family coverage, and (3) whether the employer offers one QHP or more than one QHP. The final regulations incorporate the uniform percentage requirement provisions from the proposed regulations, but also contain additional rules for how to apply the uniform percentage requirement if SHOP dependent coverage is offered (for a definition and discussion of SHOP dependent coverage, see section III.C of this preamble). The uniform percentage rule applies only to the employees who are offered coverage and does not require any particular employee or class of employees to be offered coverage.

#### B. Composite billing and list billing

The final regulations adopt the definitions of "composite billing" and "list billing" as used in the prior notices and the proposed regulations. Composite billing means a system of billing under which a health insurer charges a uniform premium for each of the employer's employees or charges a single aggregate premium for the group of covered employees that the employer may then divide by the number of covered employees to determine the uniform premium. In contrast, the term "list billing" is defined as a billing system under which a health insurer lists a separate premium for each employee based on the age of the employee or other factors.

#### C. Employers offering one QHP

For an employer offering one QHP under a composite billing system with one level of employee-only coverage, the proposed regulations provided that the uniform percentage requirement is met if the eligible small employer pays the same amount for each employee enrolled in coverage and that amount is equal to at least 50 percent of the premium for employee-only coverage. If an employer is offering one QHP under a composite billing system with different tiers of coverage (for example, employee-only or family coverage) for which different premiums are charged, the uniform percentage requirement is satisfied if the eligible small employer either: (1) pays the same amount for each employee enrolled in a particular tier of coverage and that amount is equal to at least 50 percent of the premium for that tier of coverage, or (2) pays an amount for each employee enrolled in a tier of coverage other than employee-only coverage that is the same for all employees and is no less than the amount that the employer would have contributed toward employee-only coverage for that employee (and is equal to at least 50 percent of the premium for employee-only coverage). The final regulations generally retain these provisions.

For an employer offering one QHP under a list billing system that offers only employee-only coverage, the uniform percentage requirement is satisfied if the eligible small employer either (1) pays an amount equal to a uniform percentage (not less than 50 percent) of the premium charged for each employee, or (2) determines an "employer-computed composite rate" and, if any employee contribution is required, each enrolled employee pays a uniform amount toward the employee-only premium that is no more than 50 percent of the employer-computed composite rate for employee-only coverage. The final regulations incorporate the definition of "employer-computed composite rate" from the proposed regulations as the average rate determined by adding the premiums for that tier of coverage for all employees eligible to participate in the

<sup>3</sup>The counties listed in Notice 2014-6 are: Washington - Adams, Asotin, Benton, Chelan, Clallam, Columbia, Douglas, Ferry, Franklin, Garfield, Grant, Grays Harbor, Island, Jefferson, King, Kitsap, Kittitas, Klickitat, Lewis, Lincoln, Mason, Okanogan, Pacific, Pend Oreille, Pierce, San Juan, Skagit, Skamania, Snohomish, Spokane, Stevens, Thurston, Wahkiakum, Walla Walla, Whatcom, Whitman, and Yakima counties; and Wisconsin - Green Lake, Lafayette, Marquette, Florence, and Menominee counties.

employer's health insurance plan (whether or not the eligible employee enrolls in coverage under the plan or in that tier of coverage under the plan) and dividing by the total number of such eligible employees.

For an employer offering one QHP under a list billing system with at least one tier of coverage with a higher premium than employee-only coverage, the employer satisfies the requirement if it either (1) pays an amount for each employee covered under each tier of coverage equal to or exceeding the amount that the employer would have contributed for that employee for employee-only coverage, calculated either based upon the actual premium that the insurer would have charged for that employee-only coverage or the employer-computed composite rate for employee-only coverage; or (2) meets the requirements applicable to employers offering one QHP with only employee-only coverage and using list billing described in (1) but substituting the employer-computed composite rate for each tier of coverage for the employer-computed composite rate for employee-only coverage.

In addition to incorporating the rules stated in the proposed regulations, the final regulations clarify the rules for satisfying the uniform percentage requirement in circumstances in which employers elect to offer SHOP dependent coverage to employees through the SHOP Exchange. SHOP dependent coverage is coverage offered separately to any individual who is or may become eligible for coverage under the terms of a group health plan offered through SHOP because of a relationship to a participant-employee (including an employee's domestic partner or similar relation, such as a person with whom the employee has entered into a civil union), whether or not a dependent of the participant-employee under section 152 of the Code. SHOP dependent coverage is different than family coverage in that it provides coverage only to the employee's dependents based on allowable rating factors, and does not include the participant-employee. As coverage purchased that

does not include the employee, SHOP dependent coverage is not taken into account for purposes of applying the uniformity requirement. Accordingly, regardless of whether composite or list billing is used, if an employer opts to provide SHOP dependent coverage to employees in addition to employee-only coverage, the final regulations provide that the employer does not fail to satisfy the uniform percentage requirement by contributing a different amount toward that SHOP dependent coverage than to either employee-only coverage or family coverage, even if that contribution is zero, or that contribution is different for dependents of different employees or groups of employees.<sup>4</sup> However, premiums paid for SHOP dependent coverage may be counted in determining the amount of the credit.

The final regulations provide examples of how the uniform percentage requirement is applied in these situations.

#### *D. Employers offering more than one plan*

The final regulations generally adopt the rule set forth in the proposed regulations that if an employer offers more than one QHP through a SHOP Exchange, the uniform percentage requirement may be satisfied in one of two ways. The first is on a plan-by-plan basis, meaning that the employer's premium payments for each plan individually satisfy the uniform percentage requirement stated above. The amounts or percentages of premiums paid toward each QHP do not have to be the same, but they must each satisfy the uniform percentage requirement if each QHP is tested separately. The other permissible method to satisfy the uniform percentage requirement is through the reference plan method. Under the reference plan method, the employer designates one of its QHPs as a reference plan. Then the employer determines a level of employer contributions for each employee such that, if all eligible employees enrolled in the reference plan, the contributions would satisfy the uniform percentage requirement as applied to that reference plan and the employer allows each employee to apply the amount of employer contribution deter-

mined necessary to meet the uniform percentage requirement toward the reference plan or toward coverage under any other available QHP.

#### *E. Tobacco surcharges and wellness programs*

Tobacco usage is an allowable rating factor in the SHOP Exchange that may affect employee premiums. In addition, wellness programs resulting in a premium subsidy are becoming more common. The proposed regulations did not address the impact of a tobacco surcharge or wellness program on the uniform percentage requirement. The final regulations provide that a tobacco surcharge applicable to coverage acquired on a SHOP Exchange and amounts paid by the employer to cover the surcharge are not included in premiums for purposes of calculating the uniform percentage requirement, nor are payments of the surcharge treated as premium payments for purposes of the credit. The final regulations also provide that the uniform percentage requirement is applied without regard to employee payment of the tobacco surcharges in cases in which all or part of the employee tobacco surcharges are not paid by the employer.

The final regulations also address wellness programs implemented by the employer that affect the required employee contribution (and accordingly the employer contribution). For this purpose, a wellness program refers to a wellness program as defined for purposes of the regulations under the Health Insurance Portability and Accountability Act. See § 54.9802-1(f). Specifically the final regulations provide that, for purposes of meeting the uniform percentage requirement, any additional amount of the employer contribution attributable to an employee's participation in a wellness program over the employer contribution with respect to an employee that does not participate in the wellness program is not taken into account in calculating the uniform percentage requirement, whether the difference is due to a discount for participation or a surcharge for nonparticipation. The employer contributions for employees that do not participate in the

<sup>4</sup>Section 2716 of the Public Health Service Act, which is incorporated into the Code by section 9815 of the Code, applies nondiscrimination rules similar to section 105(h) to insured group health plans. Treasury and the IRS continue to develop the nondiscrimination rules under section 2716, and compliance with section 2716 will not be required until after regulations or other administrative guidance of general applicability has been issued. See Notice 2011-1 (2011-2 IRB). The uniformity rules differ from the provisions of section 2716 so that compliance with the uniformity rules may not necessarily mean that the arrangement also complies with the requirements of section 2716.

wellness program must be at least 50 percent of the premium (including any premium surcharge for nonparticipation). However, for purposes of computing the credit, the employer contributions are taken into account, including those contributions attributable to an employee's participation in a wellness program.

#### *F. Employers complying with State law*

The Treasury Department and the IRS understand that at least one State requires employers to contribute a certain percentage (for example, 50 percent) to an employee's premium cost, but also requires that the employee's contribution not exceed a certain percentage of monthly gross earnings; as a result, in some instances, the employer's required contribution for a particular employee might exceed 50 percent of the premium. To satisfy the uniform percentage requirement under section 45R, the employer generally would be required to increase the employer contribution to all of its employees' premiums to match the increase for that one employee, which may be difficult, especially if the percentage increase is substantial. An employer will be treated as meeting the uniform percentage requirement if the failure to satisfy the uniform percentage requirement is attributable to additional employer contributions made to certain employees solely to comply with an applicable State or local law.

#### *IV. Claiming the Credit*

The proposed regulations prescribed rules for claiming the credit on the Form 8941, Credit for Small Employer Health Insurance Premiums, for reflecting the credit in estimated tax payments, and for offsetting an eligible small employer's AMT liability for the year. The proposed regulations also stated that no deduction is allowed under section 162 for that portion of the premiums paid equal to the amount of the credit claimed under section 45R. See section 280C(h). The final regulations retain these rules and provisions.

#### **Effective/Applicability Dates**

Section 1421(f), as amended by § 10105 of the Affordable Care Act, provides that section 45R applies to taxable years beginning after December 31, 2009; however, Notice 2014-6 provides transi-

tion relief for certain small employers that cannot offer a QHP through a SHOP Exchange for 2014.

These final regulations are effective on June 30, 2014. These final regulations are applicable for taxable years beginning after 2013. Alternatively, employers may rely on the provisions of the proposed regulations for taxable years beginning after 2013, and before 2015. For transition rules related to certain plan years beginning in 2014, see § 1.45R-3(i).

#### **Availability of IRS Documents**

IRS notices cited in this preamble are made available by the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402.

#### **Special Analyses**

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866, as supplemented by Executive Order 13563. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. Chapter 6) does not apply.

It is hereby certified that this regulation will not have a significant economic impact on a substantial number of small entities. Accordingly, a regulatory flexibility analysis is not required. While the number of small entities affected is substantial, the economic impact on the affected small entities is not significant. The information required to determine a small employer's eligibility for, and amount of, an applicable credit, generally consisting of the annual hours worked by its employees, the annual wages paid to its employees, the cost of the employees' premiums for qualified health plans and the employer's contribution towards those premiums, is information that the small employer generally will retain for business purposes and that will be readily available to accumulate for purposes of completing the necessary form for claiming the credit. In addition, this credit is available to any eligible small employer only twice (be-

cause the credit can be claimed by a small employer only for two consecutive taxable years beginning after 2013, beginning with the taxable year for which the small employer first claims the credit). Accordingly, no small employer will calculate the credit amount or complete the process for claiming the credit under this regulation more than twice.

Pursuant to section 7805(f) of the Code, the proposed regulations preceding these regulations were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comments on its impact on small business. No comments were received.

#### **Drafting Information**

The principal author of these regulations is Stephanie Caden, Office of the Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and the Treasury Department participated in their development.

\* \* \* \* \*

#### **Adoption of Amendments to the Regulations**

Accordingly, 26 CFR part 1 is amended as follows:

#### **PART I—INCOME TAXES**

Paragraph 1. The authority citation for part 1 continues to read in part as follows:  
Authority: 26 U.S.C. 7805 \* \* \*

Par. 2. Section 1.45R-0 is added to read as follows:

#### *§ 1.45R-0 Table of contents*

This section lists the table of contents for §§ 1.45R-1 through 1.45R-5.

#### *§ 1.45R-1 Definitions*

- (a) Definitions.
  - (1) Average premium.
  - (2) Composite billing.
  - (3) Credit period.
  - (4) Eligible small employer.
  - (5) Employee.
  - (6) Employer-computed composite rate.
  - (7) Exchange.
  - (8) Family member.

- (9) Full-time equivalent employee (FTE).
- (10) List billing.
- (11) Net premium payments.
- (12) Nonelective contribution.
- (13) Payroll taxes.
- (14) Qualified health plan QHP.
- (15) Qualifying arrangement.
- (16) Seasonal worker.
- (17) SHOP dependent coverage.
- (18) Small Business Health Options Program (SHOP).
- (19) State.
- (20) Tax-exempt eligible small employer.
- (21) Tier.
- (22) Tobacco surcharge.
- (23) United States.
- (24) Wages.
- (25) Wellness program.
- (b) Effective/applicability date.

§ 1.45R-2 Eligibility for the credit.

- (a) Eligible small employer.
- (b) Application of section 414 employer aggregation rules.
- (c) Employees taken into account.
- (d) Determining the hours of service performed by employees.
  - (1) In general.
  - (2) Permissible methods.
  - (3) Examples.
- (e) FTE calculation.
  - (1) In general.
  - (2) Example.
- (f) Determining the employer's average annual wages.
  - (1) In general.
  - (2) Example.
  - (g) Effective/applicability date.

§ 1.45R-3 Calculating the credit.

- (a) In general.
- (b) Average premium limitation.
  - (1) In general.
  - (2) Examples.
- (c) Credit phaseout.
  - (1) In general.
  - (2) \$25,000 dollar amount adjusted for inflation.
  - (3) Examples
- (d) State credits and subsidies for health insurance.
  - (1) Payments to employer.
  - (2) Payments to issuer.

- (3) Credits may not exceed net premium payment.
- (4) Examples.
- (e) Payroll tax limitation for tax-exempt eligible small employers.
  - (1) In general.
  - (2) Example.
  - (f) Two-consecutive-taxable year credit period limitation.
  - (g) Premium payments by the employer for a taxable year.
    - (1) In general.
    - (2) Excluded amounts.
  - (h) Rules applicable to trusts, estates, regulated investment companies, real estate investment trusts and cooperative organizations.
    - (i) Transition rule for 2014.
      - (1) In general.
      - (2) Example.
    - (j) Effective/applicability date.

§ 1.45R-4 Uniform percentage of premium paid.

- (a) In general.
- (b) Employers offering one QHP.
  - (1) Employers offering one QHP, self-only coverage, composite billing.
  - (2) Employers offering one QHP, other tiers of coverage, composite billing.
  - (3) Employers offering one QHP, self-only coverage, list billing.
  - (4) Employers offering one QHP, other tiers of coverage, list billing.
  - (5) Employers offering SHOP dependent coverage.
- (c) Employers offering more than one QHP.
  - (1) QHP-by-QHP method.
  - (2) Reference QHP method.
  - (d) Tobacco surcharges and wellness program discounts.
    - (i) Tobacco surcharges.
    - (ii) Wellness programs.
  - (e) Special rules regarding employer compliance with applicable State and local law.
    - (f) Examples.
    - (g) Effective/applicability date.

§ 1.45R-5 Claiming the credit.

- (a) Claiming the credit.
- (b) Estimated tax payments and alternative minimum tax (AMT) liability.
- (c) Reduction of section 162 deduction.

- (d) Effective/applicability date.

Par. 2. Sections 1.45R-1, 1.45R-2, 1.45R-3, 1.45R-4 and 1.45R-5 are added to read as follows:

§ 1.45R-1 Definitions.

(a) *Definitions.* The definitions in this section apply to this section and §§ 1.45R-2, 1.45R-3, 1.45R-4, and 1.45R-5.

(1) *Average premium.* The term *average premium* means an average premium for the small group market in the rating area in which the employee enrolls for coverage. The average premium for the small group market in a rating area is determined by the Secretary of Health and Human Services.

(2) *Composite billing.* The term *composite billing* means a system of billing under which a health insurer charges a uniform premium for each of the employer's employees or charges a single aggregate premium for the group of covered employees that the employer then divides by the number of covered employees to determine the uniform premium.

(3) *Credit period*—(i) *In general.* The term *credit period* means, with respect to any eligible small employer (or any predecessor employer), the two-consecutive-taxable-year period beginning with the first taxable year beginning after 2013, for which the eligible small employer files an income tax return with an attached Form 8941, "Credit for Small Employer Health Insurance Premiums" (or files a Form 990-T, "Exempt Organization Business Income Tax Return," with an attached Form 8941 in the case of a tax-exempt eligible employer). For a transition rule for 2014, see § 1.45R-3(i).

(ii) *Examples.* The following examples illustrate the provisions of paragraph (a)(3)(i) of this section:

*Example 1.* (i) *Facts.* In 2014, an eligible small employer (Employer) that uses a calendar year as its taxable year begins to offer insurance through a SHOP Exchange. Employer has 4 employees and otherwise qualifies for the credit, but none of the employees enroll in the coverage offered by Employer through the SHOP Exchange. In mid-2015, the 4 employees enroll for coverage through the SHOP Exchange but Employer does not file Form 8941 or claim the credit. In 2016, Employer has 20 employees and all are enrolled in coverage offered through the SHOP Exchange. Employer files Form

8941 with Employer's 2016 tax return to claim the credit.

(ii) *Conclusion.* Employer's taxable year 2016 is the first year of the credit period. Accordingly, Employer's two-year credit period is 2016 and 2017.

*Example 2.* (i) *Facts.* Same facts as *Example 1*, but Employer files Form 8941 with Employer's 2015 tax return.

(ii) *Conclusion.* Employer's taxable year 2015 is the first year of the credit period. Accordingly, Employer's two-year credit period is 2015 and 2016 (and does not include 2017). Employer is entitled to a credit based on a partial year of SHOP Exchange coverage for Employer's taxable year 2015.

(4) *Eligible small employer.* (i) The term *eligible small employer* means an employer that meets the requirements set forth in § 1.45R-2.

(ii) For the definition of tax-exempt eligible small employer, see paragraph (a)(20) of this section.

(iii) A farmers' cooperative described under section 521 that is subject to tax pursuant to section 1381, and otherwise meets the requirements of this paragraph (a)(4) and § 1.45R-2, is an eligible small employer.

(5) *Employee*—(i) *In general.* Except as otherwise specifically provided in this paragraph (a)(5), the term *employee* means an individual who is an employee of the eligible small employer under the common law standard. See § 31.3121(d)-1(c).

(ii) *Leased employees.* For purposes of this paragraph (a)(5), the term *employee* also includes a leased employee (as defined in section 414(n)).

(iii) *Certain individuals excluded.* The term *employee* does not include independent contractors (including sole proprietors), partners in a partnership, shareholders owning more than two percent of an S corporation, and any owners of more than five percent of other businesses. The term *employee* also does not include family members of these owners and partners, including the employee-spouse of a shareholder owning more than two percent of the stock of an S corporation, the employee-spouse of an owner of more than five percent of a business, the employee-spouse of a partner owning more than a five percent interest in a partnership, and the employee-spouse of a sole proprietor, or any other member of the household of these owners and partners who qualifies as a dependent under section 152(d)(2)(H).

(iv) *Seasonal workers.* The term *employee* does not include seasonal workers unless the seasonal worker provides services to the employer on more than 120 days during the taxable year.

(v) *Ministers.* Whether a minister is an employee is determined under the common law standard for determining worker status. If, under the common law standard, a minister is not an employee, the minister is not an employee for purposes of this paragraph (a)(5) and is not taken into account in determining an employer's FTEs, and premiums paid for the minister's health insurance coverage are not taken into account in computing the credit. If, under the common law standard, a minister is an employee, the minister is an employee for purposes of this paragraph (a)(5), and is taken into account in determining an employer's FTEs, and premiums paid by the employer for the minister's health insurance coverage can be taken into account in computing the credit. Because the performance of services by a minister in the exercise of his or her ministry is not treated as employment for purposes of the Federal Insurance Contributions Act (FICA), compensation paid to the minister is not wages as defined under section 3121(a), and is not counted as wages for purposes of computing an employer's average annual wages.

(vi) *Former employees.* Premiums paid on behalf of a former employee with no hours of service may be treated as paid on behalf of an employee for purposes of calculating the credit (see § 1.45R-3) provided that, if so treated, the former employee is also treated as an employee for purposes of the uniform percentage requirement (see § 1.45R-4). For the treatment of terminated employees for purposes of determining employer eligibility for the credit, see § 1.45R-2(c).

(6) *Employer-computed composite rate.* The term *employer-computed composite rate* refers to a rate for a tier of coverage (such as employee-only, dependent or family) of a QHP that is the average rate determined by adding the premiums for that tier of coverage for all employees eligible to participate in the QHP (whether or not they actually receive coverage under the plan or under that tier of coverage) and dividing by the total number of such eligible employees. The

employer-computed composite rate may be used in list billing to convert individual premiums for a tier of coverage into an employer-computed composite rate for that tier of coverage. See § 1.45R-4(b)(3).

(7) *Exchange.* The term *Exchange* means an exchange as defined in 45 CFR 155.20.

(8) *Family member.* The term *family member* is defined with respect to a taxpayer as a child (or descendant of a child); a sibling or step-sibling; a parent (or ancestor of a parent); a step-parent; a niece or nephew; an aunt or uncle; or a son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law or sister-in-law. A spouse of any of these family members is also considered a family member.

(9) *Full-time equivalent employee (FTE).* The number of *full-time equivalent employees (FTEs)* is determined by dividing the total number of hours of service for which wages were paid by the employer to employees during the taxable year by 2,080. See § 1.45R-2(d) and (e) for permissible methods of calculating hours of service and the method for calculating the number of an employer's FTEs.

(10) *List billing.* The term *list billing* refers to a system of billing under which a health insurer lists a separate premium for each employee based on the age of the employee or other factors.

(11) *Net premium payments.* The term *net premium payments* means, in the case of an employer receiving a State tax credit or State subsidy for providing health insurance to its employees, the excess of the employer's actual premium payments over the State tax credit or State subsidy received by the employer. In the case of a State payment directly to an insurance company (or another entity licensed under State law to engage in the business of insurance), the employer's net premium payments are the employer's actual premium payments. If a State-administered program (such as Medicaid or another program that makes payments directly to a health care provider or insurance company on behalf of individuals and their families who meet certain eligibility guidelines) makes payments that are not contingent on the maintenance of an

employer-provided group health plan, those payments are not taken into account in determining the employer's net premium payments.

(12) *Nonelective contribution.* The term *nonelective contribution* means an employer contribution other than a contribution pursuant to a salary reduction arrangement under section 125.

(13) *Payroll taxes.* For purposes of section 45R, the term *payroll taxes* means amounts required to be withheld as tax from the employees of a tax-exempt eligible small employer under section 3402, amounts required to be withheld from such employees under section 3101(b), and amounts of tax imposed on the tax-exempt eligible small employer under section 3111(b).

(14) *Qualified health plan or QHP.* The term *qualified health plan* or the term *QHP* means a qualified health plan as defined in Affordable Care Act section 1301(a) (see 42 U.S.C. 18021(a)), but does not include a catastrophic plan described in Affordable Care Act section 1302(e) (see 42 U.S.C. 18022(e)).

(15) *Qualifying arrangement.* The term *qualifying arrangement* means an arrangement that requires an eligible small employer to make a nonelective contribution on behalf of each employee who enrolls in a QHP offered to employees by the employer through a SHOP Exchange in an amount equal to a uniform percentage (not less than 50 percent) of the premium cost of the QHP.

(16) *Seasonal worker.* The term *seasonal worker* means a worker who performs labor or services on a seasonal basis as defined by the Secretary of Labor, including (but not limited to) workers covered by 29 CFR 500.20(s)(1), and retail workers employed exclusively during holiday seasons. Employers may apply a reasonable, good faith interpretation of the term seasonal worker and a reasonable good faith interpretation of 29 CFR 500.20(s)(1) (including as applied by analogy to workers and employment positions not otherwise covered under 29 CFR 500.20(s)(1)).

(17) *SHOP dependent coverage.* The term *SHOP dependent coverage* refers to coverage offered through SHOP separately to any individual who is or may become eligible for coverage under the

terms of a group health plan offered through SHOP because of a relationship to a participant-employee, whether or not a dependent of the participant-employee under section 152 of the Internal Revenue Code. The term *SHOP dependent coverage* does not include coverage such as family coverage, which includes coverage of the participant-employee.

(18) *Small Business Health Options Program (SHOP).* The term *Small Business Health Options Program (SHOP)* means an Exchange established pursuant to section 1311 of the Affordable Care Act and defined in 45 CFR 155.20.

(19) *State.* The term *State* means a State as defined in section 7701(a)(10), including the District of Columbia.

(20) *Tax-exempt eligible small employer.* The term *tax-exempt eligible small employer* means an eligible small employer that is exempt from federal income tax under section 501(a) as an organization described in section 501(c).

(21) *Tier.* The term *tier* refers to a category of coverage under a benefits package that varies only by the number of individuals covered. For example, employee-only coverage, dependent coverage, and family coverage would constitute three separate tiers of coverage.

(22) *Tobacco surcharge.* The term *tobacco surcharge* means any allowable differential that is charged for insurance in the SHOP Exchange that is attributable to tobacco use as the term tobacco use is defined in 45 CFR 147.102(a)(1)(iv).

(23) *United States.* The term *United States* means United States as defined in section 7701(a)(9).

(24) *Wages.* The term *wages* for purposes of section 45R means wages as defined under section 3121(a) for purposes of the Federal Insurance Contributions Act (FICA), determined without regard to the social security wage base limitation under section 3121(a)(1).

(25) *Wellness program.* The term *wellness program* for purposes of section 45R means a program of health promotion or disease prevention subject to the requirements of § 54.9802-1(f).

(b) *Effective/applicability date.* This section is applicable for periods after 2013. For rules relating to certain plan years beginning in 2014, see § 1.45R-3(i).

#### § 1.45R-2 Eligibility for the credit.

(a) *Eligible small employer.* To be eligible for the credit under section 45R, an employer must be an eligible small employer. In order to be an eligible small employer, with respect to any taxable year, an employer must have no more than 25 full-time equivalent employees (FTEs), must have in effect a qualifying arrangement, and the average annual wages of the employer's FTEs must not exceed an amount equal to twice the dollar amount in effect under § 1.45R-3(c)(2). For purposes of eligibility for the credit for taxable years beginning in or after 2014, a qualifying arrangement is an arrangement that requires an employer to make a nonelective contribution on behalf of each employee who enrolls in a qualified health plan (QHP) offered to employees through a small business health options program (SHOP) Exchange in an amount equal to a uniform percentage (not less than 50 percent) of the premium cost of the QHP. Notwithstanding the foregoing, an employer that is an agency or instrumentality of the federal government, or of a State, local or Indian tribal government, is not an eligible small employer if it is not an organization described in section 501(c) that is exempt from tax under section 501(a). An employer does not fail to be an eligible small employer merely because its employees are not performing services in a trade or business of the employer. An employer located outside the United States (including an employer located in a U.S. territory) must have income effectively connected with the conduct of a trade or business in the United States, and otherwise meet the requirements of this section, to be an eligible small employer. For eligibility standards for SHOP related to foreign employers, see 45 CFR 155.710. Paragraphs (b) through (f) of this section provide the rules for determining whether the requirements to be an eligible small employer are met, including rules related to identifying and counting the number of the employer's FTEs, counting the employees' hours of service, and determining the employer's average annual FTE wages for the taxable year. For rules on determining whether the uniform percentage requirement is met, see § 1.45R-4.

(b) *Application of section 414 employer aggregation rules.* All employers treated as a single employer under section 414(b), (c), (m) or (o) are treated as a single employer for purposes of this section. Thus, all employees of a controlled group under section 414(b), (c) or (o), or an affiliated service group under section 414(m), are taken into account in determining whether any member of the controlled group or affiliated service group is an eligible small employer. Similarly, all wages paid to, and premiums paid for, employees by the members of the controlled group or affiliated service group are taken into account when determining the amount of the credit for a group treated as a single employer under these rules.

(c) *Employees taken into account.* To be eligible for the credit, an employer must have employees as defined in § 1.45R-1(a)(5) during the taxable year. All such employees of the eligible small employer are taken into account for purposes of determining the employer's FTEs and average annual FTE wages. Employees include employees who terminate employment during the year for which the credit is being claimed, employees covered under a collective bargaining agreement, and employees who do not enroll in a QHP offered by the employer through a SHOP Exchange.

(d) *Determining the hours of service performed by employees—(1) In general.* An employee's hours of service for a year include each hour for which an employee is paid, or entitled to payment, for the performance of duties for the employer during the employer's taxable year. It also includes each hour for which an employee is paid, or entitled to payment, by the employer on account of a period of time during which no duties are performed due to vacation, holiday, illness, incapacity (including disability), layoff, jury duty, military duty or leave of absence (except that no more than 160 hours of service are required to be counted for an employee on account of any single continuous period during which the employee performs no duties).

(2) *Permissible methods.* In calculating the total number of hours of service that must be taken into account for an employee during the taxable year, eligible

small employers need not use the same method for all employees, and may apply different methods for different classifications of employees if the classifications are reasonable and consistently applied. Eligible small employers may change the method for calculating employees' hours of service for each taxable year. An eligible small employer may use any of the following three methods.

(i) *Actual hours worked.* An employer may use the actual hours of service provided by employees including hours worked and any other hours for which payment is made or due (as described in paragraph (d)(1) of this section).

(ii) *Days-worked equivalency.* An employer may use a days-worked equivalency whereby the employee is credited with 8 hours of service for each day for which the employee would be required to be credited with at least one hour of service under paragraph (d)(1) of this section.

(iii) *Weeks-worked equivalency.* An employer may use a weeks-worked equivalency whereby the employee is credited with 40 hours of service for each week for which the employee would be required to be credited with at least one hour of service under paragraph (d)(1) of this section.

(3) *Examples.* The following examples illustrate the rules of paragraph (d) of this section:

*Example 1. Counting hours of service by hours actually worked or for which payment is made or due.* (i) *Facts.* An eligible small employer (Employer) has payroll records that indicate that Employee A worked 2,000 hours and that Employer paid Employee A for an additional 80 hours on account of vacation, holiday and illness. Employer uses the actual hours worked method described in paragraph (d)(2)(i) of this section.

(ii) *Conclusion.* Under this method of counting hours, Employee A must be credited with 2,080 hours of service (2,000 hours worked and 80 hours for which payment was made or due).

*Example 2. Counting hours of service under days-worked equivalency.* (i) *Facts.* Employee B worked from 8:00am to 12:00pm every day for 200 days. Employer uses the days-worked equivalency method described in paragraph (d)(2)(ii) of this section.

(ii) *Conclusion.* Under this method of counting hours, Employee B must be credited with 1,600 hours of service (8 hours for each day Employee B would otherwise be credited with at least 1 hour of service x 200 days).

*Example 3. Counting hours of service under weeks-worked equivalency.* (i) *Facts.* Employee C

worked 49 weeks, took 2 weeks of vacation with pay, and took 1 week of leave without pay. Employer uses the weeks-worked equivalency method described in paragraph (d)(2)(iii) of this section.

(ii) *Conclusion.* Under this method of counting hours, Employee C must be credited with 2,040 hours of service (40 hours for each week during which Employee C would otherwise be credited with at least 1 hour of service x 51 weeks).

*Example 4. Excluded employees.* (i) *Facts.* Employee D worked 3 consecutive weeks at 32 hours per week during the holiday season. Employee D did not work during the remainder of the year. Employee E worked limited hours after school from time to time through the year for a total of 350 hours. Employee E does not work through the summer. Employer uses the actual hours worked method described in paragraph (d)(2)(i) of this section.

(ii) *Conclusion.* Employee D is a seasonal employee who worked for 120 days or less for Employer during the year. Employee D's hours are not counted when determining the hours of service of Employer's employees. Employee E works throughout most of the year and is not a seasonal employee. Employer counts Employee E's 350 hours of service during the year.

(e) *FTE Calculation—(1) In general.* The number of an employer's FTEs is determined by dividing the total hours of service, determined in accordance with paragraph (d) of this section, credited during the year to employees taken into account under paragraph (c) of this section (but not more than 2,080 hours for any employee) by 2,080. The result, if not a whole number, is then rounded to the next lowest whole number. If, however, after dividing the total hours of service by 2,080, the resulting number is less than one, the employer rounds up to one FTE.

(2) *Example.* The following example illustrates the provisions of paragraph (e) of this section:

*Example. Determining the number of FTEs.* (i) *Facts.* A sole proprietor pays 5 employees wages for 2,080 hours each, pays 3 employees wages for 1,040 hours each, and pays 1 employee wages for 2,300 hours. One of the employees working 2,080 hours is the sole proprietor's nephew. The sole proprietor's FTEs would be calculated as follows: 8,320 hours of service for the 4 employees paid for 2,080 hours each (4 x 2,080); the sole proprietor's nephew is excluded from the FTE calculation; 3,120 hours of service for the 3 employees paid for 1,040 hours each (3 x 1,040); and 2,080 hours of service for the 1 employee paid for 2,300 hours (lesser of 2,300 and 2,080). The sum of the included hours of service equals 13,520 hours of service.

(ii) *Conclusion.* The sole proprietor's FTEs equal 6 (13,520 divided by 2,080 = 6.5, rounded to the next lowest whole number).

(f) *Determining the employer's average annual FTE wages—(1) In general.* All wages paid to employees (including

overtime pay) are taken into account in computing an eligible small employer's average annual FTE wages. The average annual wages paid by an employer for a taxable year is determined by dividing the total wages paid by the eligible small employer during the employer's taxable year to employees taken into account under paragraph (c) of this section by the number of the employer's FTEs for the year. The result is then rounded down to the nearest \$1,000 (if not otherwise a multiple of \$1,000). For purposes of determining the employer's average annual wages for the taxable year, only wages that are paid for hours of service determined under paragraph (d) of this section are taken into account.

(2) *Example.* The following example illustrates the provision of paragraphs (e) and (f) of this section:

*Example.* (i) *Facts.* An employer has 26 FTEs with average annual wages of \$23,000. Only 22 of the employer's employees enroll for coverage offered by the employer through a SHOP Exchange.

(ii) *Conclusion.* The hours of service and wages of all employees are taken into consideration in determining whether the employer is an eligible small employer for purposes of the credit. Because the employer does not have fewer than 25 FTEs for the taxable year, the employer is not an eligible small employer for purposes of this section, even if fewer than 25 employees (or FTEs) enroll for coverage through the SHOP Exchange.

(g) *Effective/applicability date.* This section is applicable for periods after 2013. For transition rules relating to certain plan years beginning in 2014, see § 1.45R-3(i).

### § 1.45R-3 Calculating the credit.

(a) *In general.* The tax credit available to an eligible small employer equals 50 percent of the eligible small employer's premium payments made on behalf of its employees under a qualifying arrangement, or in the case of a tax-exempt eligible small employer, 35 percent of the employer's premium payments made on behalf of its employees under a qualifying arrangement. The employer's tax credit is subject to the following adjustments and limitations:

(1) The average premium limitation for the small group market in the rating area in which the employee enrolls for coverage, described in paragraph (b) of this section;

(2) The credit phaseout described in paragraph (c) of this section;

(3) The net premium payment limitation in the case of State credits or subsidies described in paragraph (d) of this section;

(4) The payroll tax limitation for a tax-exempt eligible small employer described in paragraph (e) of this section;

(5) The two-consecutive-taxable year-credit period limitation, described in paragraph (f) of this section;

(6) The rules with respect to the premium payments taken into account, described in paragraph (g) of this section;

(7) The rules with respect to credits applicable to trusts, estates, regulated investment companies, real estate investment trusts and cooperatives described in paragraph (h) of this section; and

(8) The transition relief for 2014 described in paragraph (i) of this section.

(b) *Average premium limitation—(1) In general.* The amount of an eligible small employer's premium payments that is taken into account in calculating the credit is limited to the premium payments the employer would have made under the same arrangement if the average premium for the small group market in the rating area in which the employee enrolls for coverage were substituted for the actual premium.

(2) *Examples.* The following examples illustrate the provisions of paragraph (b)(1) of this section:

*Example 1. Comparing premium payments to average premium for small group market.* (i) *Facts.* An eligible small employer (Employer) offers a health insurance plan with employee-only and SHOP dependent coverage through a small business options program (SHOP) Exchange. Employer has 9 full-time equivalent employees (FTEs) with average annual wages of \$23,000 per FTE. All 9 employees are employees as defined under § 1.45R-1(a)(5). Six employees are enrolled in employee-only coverage and 5 of these 6 employees have also enrolled either one child or one spouse in SHOP dependent coverage. Employer pays 50% of the premiums for all employees enrolled in employee-only coverage and 50% of the premiums for all employees who enrolled family members in SHOP dependent coverage (and the employee is responsible for the remainder in each case). The premiums are \$4,000 a year for employee-only coverage and \$3,000 a year for each individual enrolled in SHOP dependent coverage. The average premium for the small group market in Employer's rating area is \$5,000 for employee-only coverage and \$4,000 for each individual enrolled in SHOP dependent coverage. Employer's premium payments for each FTE (\$2,000 for employee-only

coverage and \$1,500 for SHOP dependent coverage) do not exceed 50 percent of the average premium for the small group market in Employer's rating area (\$2,500 for employee-only coverage and \$2,000 for each individual enrolled in SHOP dependent coverage).

(ii) *Conclusion.* The amount of premiums paid by Employer for purposes of computing the credit equals \$19,500 ((6 x \$2,000) plus (5 x \$1,500)).

*Example 2. Premium payments exceeding average premium for small group market.* (i) *Facts.* Same facts as *Example 1*, except that the premiums are \$6,000 for employee-only coverage and \$5,000 for each dependent enrolled in coverage. Employer's premium payments for each employee (\$3,000 for employee-only coverage and \$2,500 for SHOP dependent coverage) exceed 50% of the average premium for the small group market in Employer's rating area (\$2,500 for self-only coverage and \$2,000 for family coverage).

(ii) *Conclusion.* The amount of premiums paid by Employer for purposes of computing the credit equals \$25,000 ((6 x \$2,500) plus (5 x \$2,000)).

(c) *Credit phaseout—(1) In general.* The tax credit is subject to a reduction (but not reduced below zero) if the employer's FTEs exceed 10 or average annual FTE wages exceed \$25,000. If the number of FTEs exceeds 10, the reduction is determined by multiplying the otherwise applicable credit amount by a fraction, the numerator of which is the number of FTEs in excess of 10 and the denominator of which is 15. If average annual FTE wages exceed \$25,000, the reduction is determined by multiplying the otherwise applicable credit amount by a fraction, the numerator of which is the amount by which average annual FTE wages exceed \$25,000 and the denominator of which is \$25,000. In both cases, the result of the calculation is subtracted from the otherwise applicable credit to determine the credit to which the employer is entitled. For an employer with both more than 10 FTEs and average annual FTE wages exceeding \$25,000, the total reduction is the sum of the two reductions.

(2) *\$25,000 dollar amount adjusted for inflation.* For taxable years beginning in a calendar year after 2013, each reference to "\$25,000" in paragraph (c)(1) of this section is replaced with a dollar amount equal to \$25,000 multiplied by the cost-of-living adjustment under section 1(f)(3) for the calendar year, determined by substituting "calendar year 2012" for "calendar year 1992" in section 1(f)(3)(B).

(3) *Examples.* The following examples illustrate the provisions of paragraph (c) this section. For purposes of these exam-

ples, no employer is a tax-exempt organization and no other adjustments or limitations on the credit apply other than those adjustments and limitations explicitly set forth in the example.

*Example 1. Calculating the maximum credit for an eligible small employer without an applicable credit phaseout.* (i) *Facts.* An eligible small employer (Employer) has 9 FTEs with average annual wages of \$23,000. Employer pays \$72,000 in health insurance premiums for those employees (which does not exceed the total average premium for the small group market in the rating area), and otherwise meets the requirements for the credit.

(ii) *Conclusion.* Employer's credit equals \$36,000 (50% x \$72,000).

*Example 2. Calculating the credit phaseout if the number of FTEs exceeds 10 or average annual wages exceed \$25,000, as adjusted for inflation.* (i) *Facts.* An eligible small employer (Employer) has 12 FTEs and average annual FTE wages of \$30,000 in a year when the amount in paragraph (c)(1) of this section, as adjusted for inflation, is \$25,000. Employer pays \$96,000 in health insurance premiums for its employees (which does not exceed the average premium for the small group market in the rating area) and otherwise meets the requirements for the credit.

(ii) *Conclusion.* The initial amount of the credit is determined before any reduction (50% x \$96,000) = \$48,000. The credit reduction for FTEs in excess of 10 is \$6,400 ( $\$48,000 \times 2/15$ ). The credit reduction for average annual FTE wages in excess of \$25,000 is \$9,600 ( $\$48,000 \times \$5,000/\$25,000$ ), resulting in a total credit reduction of \$16,000 ( $\$6,400 + \$9,600$ ). Employer's total tax credit equals \$32,000 ( $\$48,000 - \$16,000$ ).

(d) *State credits and subsidies for health insurance—(1) Payments to employer.* If the employer is entitled to a State tax credit or a premium subsidy that is paid directly to the employer, the premium payment made by the employer is not reduced by the credit or subsidy for purposes of determining whether the employer has satisfied the requirement to pay an amount equal to a uniform percentage (not less than 50 percent) of the premium cost. Also, except as described in paragraph (d)(3) of this section, the maximum amount of the credit is not reduced by reason of a State tax credit or subsidy or by reason of payments by a State directly to an employer.

(2) *Payments to issuer.* If a State makes payments directly to an insurance company (or another entity licensed under State law to engage in the business of insurance) to pay a portion of the premium for coverage of an employee enrolled for coverage through a SHOP Exchange, the State is treated as making

these payments on behalf of the employer for purposes of determining whether the employer has satisfied the requirement to pay an amount equal to a uniform percentage (not less than 50 percent) of the premium cost of coverage. Also, except as described below in paragraph (d)(3) of this section, these premium payments by the State are treated as an employer contribution under this section for purposes of calculating the credit.

(3) *Credits may not exceed net premium payment.* Regardless of the application of paragraphs (d)(1) and (d)(2) of this section, in no event may the amount of the credit exceed the amount of the employer's net premium payments as defined in § 1.45R-1(a)(11).

(4) *Examples.* The following examples illustrate the provisions of paragraphs (d)(1) through (d)(3) of this section. For purposes of these examples, each employer is an eligible small employer that is not a tax-exempt organization and the eligible small employer's taxable year and plan year begin during or after 2014. No other adjustments or limitations on the credit apply other than those adjustments and limitations explicitly set forth in the example.

*Example 1. State premium subsidy paid directly to employer.* (i) *Facts.* The State in which an eligible small employer (Employer) operates provides a health insurance premium subsidy of up to 40% of the health insurance premiums for each eligible employee. The State pays the subsidy directly to Employer. Employer has one employee, Employee D. Employee D's health insurance premiums are \$100 per month and are paid as follows: \$80 by Employer and \$20 by Employee D through salary reductions to a cafeteria plan. The State pays Employer \$40 per month as a subsidy for Employer's payment of insurance premiums on behalf of Employee D. Employer is otherwise an eligible small employer that meets the requirements for the credit.

(ii) *Conclusion.* For purposes of calculating the credit, the amount of premiums paid by the employer is \$80 per month (the premium payment by the Employer without regard to the subsidy from the State). The maximum credit is \$40 ( $\$80 \times 50\%$ ).

*Example 2. State premium subsidy paid directly to insurance company.* (i) *Facts.* The State in which Employer operates provides a health insurance premium subsidy of up to 30% for each eligible employee. Employer has one employee, Employee E. Employee E is enrolled in employee-only coverage through a qualified health plan (QHP) offered by Employer through a SHOP Exchange. Employee E's health insurance premiums are \$100 per month and are paid as follows: \$50 by Employer; \$30 by the State and \$20 by the employee. The State pays the \$30 per month directly to the insurance company and

the insurance company bills Employer for the employer and employee's share, which equal \$70 per month. Employer is otherwise an eligible small employer that meets the requirements for the credit.

(ii) *Conclusion.* For purposes of calculating the amount of the credit, the amount of premiums paid by Employer is \$80 per month (the sum of Employer's payment and the State's payment). The maximum credit is \$40 ( $\$80 \times 50\%$ ).

*Example 3. Credit limited by employer's net premium payment.* (i) *Facts.* The State in which Employer operates provides a health insurance premium subsidy of up to 50% for each eligible employee. Employer has one employee, Employee F. Employee F is enrolled in employee-only coverage under the QHP offered to Employee F by Employer through a SHOP Exchange. Employee F's health insurance premiums are \$100 per month and are paid as follows: \$20 by Employer; \$50 by the State and \$30 by Employee F. The State pays the \$50 per month directly to the insurance company and the insurance company bills Employer for the employer's and employee's shares, which total \$50 per month. The amount of premiums paid by Employer (the sum of Employer's payment and the State's payment) is \$70 per month, which is more than 50% of the \$100 monthly premium payment. The amount of the premium for calculating the credit is also \$70 per month.

(ii) *Conclusion.* The maximum credit without adjustments or limitations is \$35 ( $\$70 \times 50\%$ ). Employer's net premium payment is \$20 (the amount actually paid by Employer excluding the State subsidy). Because the credit may not exceed Employer's net premium payment, the credit is \$20 (the lesser of \$35 or \$20).

(e) *Payroll tax limitation for tax-exempt eligible small employers—(1) In general.* For a tax-exempt eligible employer, the amount of the credit claimed cannot exceed the total amount of payroll taxes (as defined in § 1.45R-1(a)(13)) of the employer during the calendar year in which the taxable year begins.

(2) *Example.* The following example illustrates the provisions of paragraph (e)(1) of this section. For purposes of this example, the eligible small employer's taxable year and plan year begin during or after 2014. No other adjustments or limitations on the credit apply other than those adjustments and limitations explicitly set forth in the example.

*Example. Calculating the maximum credit for a tax-exempt eligible small employer.* (i) *Facts.* Employer is a tax-exempt eligible small employer that has 10 FTEs with average annual wages of \$21,000. Employer pays \$80,000 in health insurance premiums for its employees (which does not exceed the average premium for the small group market in the rating area) and otherwise meets the requirements for the credit. The total amount of Employer's payroll taxes equals \$30,000.

(ii) *Conclusion.* The initial amount of the credit is determined before any reduction: ( $35\% \times \$80,000$ ) = \$28,000, and Employer's payroll taxes are

\$30,000. The total tax credit equals \$28,000 (the lesser of \$28,000 and \$30,000).

(f) *Two-consecutive-taxable-year credit period limitation.* The credit is available to an eligible small employer, including a tax-exempt eligible small employer, only during that employer's credit period. For a transition rule for 2014, see paragraph (i) of this section. To prevent the avoidance of the two-year limit on the credit period through the use of successor entities, a successor entity and a predecessor entity are treated as the same employer. For this purpose, the rules for identifying successor entities under § 31.3121(a)(1)–1(b) apply. Accordingly, for example, if an eligible small employer claims the credit for the 2014 and 2015 taxable years, that eligible small employer's credit period will have expired so that any successor employer to that eligible small employer will not be able to claim the credit for any subsequent taxable years.

(g) *Premium payments by the employer for a taxable year—(1) In general.* Only premiums paid by an eligible small employer or tax-exempt eligible small employer on behalf of each employee enrolled in a QHP or payments paid to the issuer in accordance with paragraph (d)(2) of this section are counted in calculating the credit. If an eligible small employer pays only a portion of the premiums for the coverage provided to employees (with employees paying the rest), only the portion paid by the employer is taken into account. Premiums paid on behalf of seasonal workers may be counted in determining the amount of the credit (even though seasonal worker wages and hours of service are not included in the FTE calculation and average annual FTE wage calculation unless the seasonal worker works for the employer on more than 120 days during the taxable year). Subject to the average premium limitation, premiums paid on behalf of an employee with respect to any individuals who are or may become eligible for coverage under the terms of the plan because of a relationship to the employee (including through family coverage or SHOP dependent coverage) may also be taken into account in determining the amount of the credit. (However, premiums paid for SHOP dependent coverage are not taken into account in determining whether the uniform percent-

age requirement is met, see § 1.45R–4(b)(5).)

(2) *Excluded amounts—(i) Salary reduction amounts.* Any premium paid pursuant to a salary reduction arrangement under a section 125 cafeteria plan is not treated as paid by the employer for purposes of section 45R and these regulations. For this purpose, premiums paid with employer-provided flex credits that employees may elect to receive as cash or other taxable benefits are treated as paid pursuant to a salary reduction arrangement under a section 125 cafeteria plan.

(ii) *HSA, HRA, and FSA.* Employer contributions to, or amounts made available under, health savings accounts, reimbursement arrangements, and health flexible spending arrangements are not taken into account in determining the premium payments by the employer for a taxable year.

(h) *Rules applicable to trusts, estates, regulated investment companies, real estate investment trusts and cooperative organizations.* Rules similar to the rules of section 52(d) and (e) and the regulations thereunder apply in calculating and apportioning the credit with respect to a trust, estate, a regulated investment company or real estate investment trusts or cooperative organization.

(i) *Transition rule for 2014—(1) In general.* This paragraph (i) applies if as of August 26, 2013, an eligible small employer offers coverage for a health plan year that begins on a date other than the first day of its taxable year. In such a case, if the eligible small employer has a health plan year beginning after January 1, 2014 but before January 1, 2015 (2014 health plan year) that begins after the start of its first taxable year beginning on or after January 1, 2014 (2014 taxable year), and the employer offers one or more QHPs to its employees through a SHOP Exchange as of the first day of its 2014 health plan year, then the eligible small employer is treated as offering coverage through a SHOP Exchange for its entire 2014 taxable year for purposes of section 45R if the health care coverage provided from the first day of the 2014 taxable year through the day immediately preceding the first day of the 2014 health plan year would have qualified for a credit under section 45R using the rules applicable to

taxable years beginning before January 1, 2014. If the eligible small employer claims the section 45R credit in the 2014 taxable year, the 2014 taxable year begins the first year of the credit period.

(2) *Example.* The following example illustrates the rule of this paragraph (i) of this section. For purposes of this example, it is assumed that the eligible small employer is not a tax-exempt organization and that no other adjustments or limitations on the credit apply other than those adjustments and limitations explicitly set forth in the example.

*Example. (i) Facts.* An eligible small employer (Employer) has a 2014 taxable year that begins January 1, 2014 and ends on December 31, 2014. As of August 26, 2013, Employer had a 2014 health plan year that begins July 1, 2014 and ends June 30, 2015. Employer offers a QHP through a SHOP Exchange the coverage under which begins July 1, 2014. Employer also provides other coverage from January 1, 2014 through June 30, 2014 that would have qualified for a credit under section 45R based on the rules applicable to taxable years beginning before 2014.

(ii) *Conclusion.* Employer may claim the credit at the 50% rate under section 45R for the entire 2014 taxable year using the rules under this paragraph (i) of this section. Accordingly, in calculating the credit, Employer may count premiums paid for the coverage from January 1, 2014 through June 30, 2014, as well as premiums paid for the coverage from July 1, 2014 through December 31, 2014. If Employer claims the credit for the 2014 taxable year, that taxable year is the first year of the credit period.

(j) *Effective/applicability date.* This section is applicable for periods after 2013. For transition rules relating to certain plan years beginning in 2014, see paragraph (i) of this section.

*§ 1.45R–4 Uniform percentage of premium paid.*

(a) *In general.* An eligible small employer must pay a uniform percentage (not less than 50 percent) of the premium for each employee enrolled in a qualified health plan (QHP) offered to employees by the employer through a small business health options program (SHOP) Exchange.

(b) *Employers offering one QHP.* An employer that offers a single QHP through a SHOP Exchange must satisfy the requirements of this paragraph (b).

(1) *Employers offering one QHP, employee-only coverage, composite billing.* For an eligible small employer offering employee-only coverage and using composite billing, the employer satisfies the requirements of this paragraph if it

pays the same amount toward the premium for each employee receiving employee-only coverage under the QHP, and that amount is equal to at least 50 percent of the premium for employee-only coverage.

(2) *Employers offering one QHP, other tiers of coverage, composite billing.* For an eligible small employer offering one QHP providing at least one tier of coverage with a higher premium than employee-only coverage and using composite billing, the employer satisfies the requirements of this paragraph (b)(2) if it either—

(i) Pays an amount for each employee enrolled in that more expensive tier of coverage that is the same for all employees and that is no less than the amount that the employer would have contributed toward employee-only coverage for that employee, or

(ii) Meets the requirements of paragraph (b)(1) of this section for each tier of coverage that it offers.

(3) *Employers offering one QHP, employee-only coverage, list billing.* For an eligible small employer offering one QHP providing only employee-only coverage and using list billing, the employer satisfies the requirements of this paragraph (b)(3) if either—

(i) The employer pays toward the premium an amount equal to a uniform percentage (not less than 50 percent) of the premium charged for each employee, or

(ii) The employer converts the individual premiums for employee-only coverage into an employer-computed composite rate for self-only coverage, and, if an employee contribution is required, each employee who receives coverage under the QHP pays a uniform amount toward the employee-only premium that is no more than 50 percent of the employer-computed composite rate for employee-only coverage.

(4) *Employers offering one QHP, other tiers of coverage, list billing.* For an eligible small employer offering one QHP providing at least one tier of coverage with a higher premium than employee-only coverage and using list billing, the employer satisfies the requirements of this paragraph (b)(4) if it either—

(i) Pays toward the premium for each employee covered under each tier of cov-

erage an amount equal to or exceeding the amount that the employer would have contributed with respect to that employee for employee-only coverage, calculated either based upon the actual premium that would have been charged by the insurer for that employee for employee-only coverage or based upon the employer-computed composite rate for employee-only coverage, or

(ii) Meets the requirements of paragraph (b)(3) of this section for each tier of coverage that it offers substituting the employer-computed composite rate for each tier of coverage for the employer-computed composite rate for employee-only coverage.

(5) *Employers offering SHOP dependent coverage.* If SHOP dependent coverage is offered through the SHOP Exchange, the employer does not fail to satisfy the uniform percentage requirement by contributing a different amount toward that SHOP dependent coverage, even if that contribution is zero. For treatment of premiums paid on behalf of an employee's dependents, see § 1.45R-3(g)(1).

(c) *Employers offering more than one QHP.* If an eligible small employer offers more than one QHP, the employer must satisfy the requirements of this paragraph (c). The employer may satisfy the requirements of this paragraph (c) in either of the following two ways:

(1) *QHP-by-QHP method.* The employer makes payments toward the premium with respect to each QHP for which the employer is claiming the credit that satisfy the uniform percentage requirement under paragraph (b) of this section on a QHP-by-QHP basis (so that the amounts or percentages of premium paid by the employer for each QHP need not be identical, but the payments with respect to each QHP must satisfy paragraph (b) of this section); or

(2) *Reference QHP method.* The employer designates a reference QHP and makes employer contributions in accordance with the following requirements—

(i) The employer determines a level of employer contributions for each employee such that, if all eligible employees enrolled in the reference QHP, the contributions would satisfy the uniform percent-

age requirement under paragraph (b) of this section, and

(ii) The employer allows each employee to apply an amount of employer contribution determined necessary to meet the uniform percentage requirement under paragraph (b) of this section either toward the reference QHP or toward the cost of coverage under any of the other available QHPs.

(d) *Tobacco surcharges and wellness program discounts—(i) Tobacco surcharges.* The tobacco surcharge and amounts paid by the employer to cover the surcharge are not included in premiums for purposes of calculating the uniform percentage requirement, nor are payments of the surcharge treated as premium payments for purposes of calculating the credit. The uniform percentage requirement is also applied without regard to employee payment of the tobacco surcharges in cases in which all or part of the employee tobacco surcharges are not paid by the employer.

(ii) *Wellness programs.* If a plan of an employer provides a wellness program, for purposes of meeting the uniform percentage requirement any additional amount of the employer contribution attributable to an employee's participation in the wellness program over the employer contribution with respect to an employee that does not participate in the wellness program is not taken into account in calculating the uniform percentage requirement, whether the difference is due to a discount for participation or a surcharge for nonparticipation. The employer contribution for employees that do not participate in the wellness program must be at least 50 percent of the premium (including any premium surcharge for nonparticipation). However, for purposes of computing the credit, the employer contributions are taken into account, including those contributions attributable to an employee's participation in a wellness program.

(e) *Special rules regarding employer compliance with applicable State or local law.* An employer will be treated as satisfying the uniform percentage requirement if the failure to otherwise satisfy the uniform percentage requirement is attributable solely to additional employer contributions made to certain employees to

comply with an applicable State or local law.

(f) *Examples.* The following examples illustrate the provisions of paragraphs (a) through (e) of this section:

*Example 1. (i) Facts.* An eligible small employer (Employer) offers a QHP on a SHOP Exchange, Plan A, which uses composite billing. The premiums for Plan A are \$5,000 per year for employee-only coverage, and \$10,000 for family coverage. Employees can elect employee-only or family coverage under Plan A. Employer pays \$3,000 (60% of the premium) toward employee-only coverage under Plan A and \$6,000 (60% of the premium) toward family coverage under Plan A.

(ii) *Conclusion.* Employer's contributions of 60% of the premium for each tier of coverage satisfy the uniform percentage requirement.

*Example 2. (i) Facts.* Same facts as *Example 1*, except that Employer pays \$3,000 (60% of the premium) for each employee electing employee-only coverage under Plan A and pays \$3,000 (30% of the premium) for each employee electing family coverage under Plan A.

(ii) *Conclusion.* Employer's contributions of 60% of the premium toward employee-only coverage and the same dollar amount toward the premium for family coverage satisfy the uniform percentage requirement, even though the percentage is not the same.

*Example 3. (i) Facts.* Employer offers two QHPs, Plan A and Plan B, both of which use composite billing. The premiums for Plan A are \$5,000 per year for employee-only coverage and \$10,000 for family coverage. The premiums for Plan B are \$7,000 per year for employee-only coverage and \$13,000 for family coverage. Employees can elect employee-only or family coverage under either Plan A or Plan B. Employer pays \$3,000 (60% of the premium) for each employee electing employee-only coverage under Plan A, \$3,000 (30% of the premium) for each employee electing family coverage under Plan A, \$3,500 (50% of the premium) for each employee electing employee-only coverage under Plan B, and \$3,500 (27% of the premium) for each employee electing family coverage under Plan B.

(ii) *Conclusion.* Employer's contributions of 60% (or \$3,000) of the premiums for employee-only coverage and the same dollar amounts toward the premium for family coverage under Plan A, and of 50% (or \$3,500) of the premium for employee-only coverage and the same dollar amount toward the premium for family coverage under Plan B, satisfy the uniform percentage requirement on a QHP-by-QHP basis; therefore the employer's contributions to both plans satisfy the uniform percentage requirement.

*Example 4. (i) Facts.* Same facts as *Example 3*, except that Employer designates Plan A as the reference QHP. Employer pays \$2,500 (50% of the premium) for each employee electing employee-only coverage under Plan A and pays \$2,500 of the premium for each employee electing family coverage under Plan A or either employee-only or family coverage under Plan B.

(ii) *Conclusion.* Employer's contribution of 50% (or \$2,500) toward the premium of each employee

enrolled under Plan A or Plan B satisfies the uniform percentage requirement.

*Example 5. (i) Facts.* Employer receives a list billing premium quote with respect to Plan X, a QHP offered by Employer on a SHOP Exchange for health insurance coverage for each of Employer's four employees. For Employee L, age 20, the employee-only premium is \$3,000 per year, and the family premium is \$8,000. For Employees M, N and O, each age 40, the employee-only premium is \$5,000 per year and the family premium is \$10,000. The total employee-only premium for the four employees is \$18,000 ( $\$3,000 + (3 \times 5,000)$ ). Employer calculates an employer-computed composite employee-only rate of \$4,500 ( $\$18,000 / 4$ ). Employer offers to make contributions such that each employee would need to pay \$2,000 of the premium for employee-only coverage. Under this arrangement, Employer would contribute \$1,000 toward employee-only coverage for L and \$3,000 toward employee-only coverage for M, N, and O. In the event an employee elects family coverage, Employer would make the same contribution (\$1,000 for L or \$3,000 for M, N, or O) toward the family premium.

(ii) *Conclusion.* Employer satisfies the uniform percentage requirement because it offers and makes contributions based on an employer-calculated composite employee-only rate such that, to receive employee-only coverage, each employee must pay a uniform amount which is not more than 50% of the composite rate, and it allows employees to use the same employer contributions toward family coverage.

*Example 6. (i) Facts.* Same facts as *Example 5*, except that Employer calculates an employer-computed composite family rate of \$9,500 ( $(\$8,000 + 3 \times 10,000) / 4$ ) and requires each employee to pay \$4,000 of the premium for family coverage.

(ii) *Conclusion.* Employer satisfies the uniform percentage requirement because it offers and makes contributions based on a calculated employee-only and family rate such that, to receive either employee-only or family coverage, each employee must pay a uniform amount which is not more than 50% of the composite rate for coverage of that tier.

*Example 7. (i) Facts.* Same facts as *Example 5*, except that Employer also receives a list billing premium quote from Plan Y with respect to a second QHP offered by Employer on a SHOP Exchange for each of Employer's 4 employees. Plan Y's quote for Employee L, age 20, is \$4,000 per year for employee-only coverage or \$12,000 per year for family coverage. For Employees M, N and O, each age 40, the premium is \$7,000 per year for employee-only coverage or \$15,000 per year for family coverage. The total employee-only premium under Plan Y is \$25,000 ( $\$4,000 + (3 \times 7,000)$ ). The employer-computed composite employee-only rate is \$6,250 ( $\$25,000 / 4$ ). Employer designates Plan X as the reference plan. Employer offers to make contributions based on the employer-calculated composite premium for the reference QHP (Plan X) such that each employee has to contribute \$2,000 to receive employee-only coverage through Plan X. Under this arrangement, Employer would contribute \$1,000 toward employee-only coverage for L and \$3,000 toward employee-only coverage for M, N, and O. In the event an employee elects family coverage through Plan X or either employee-only or

family coverage through Plan Y, Employer would make the same contributions (\$1,000 for L or \$3,000 for M, N, or O) toward that coverage.

(ii) *Conclusion.* Employer satisfies the uniform percentage requirement because it offers and makes contributions based on the employer-calculated composite employee-only premium for the Plan X reference QHP such that, in order to receive employee-only coverage, each employee must pay a uniform amount which is not more than 50% of the employee-only composite premium of the reference QHP; it allows employees to use the same employer contributions toward family coverage in the reference QHP or coverage through another QHPs.

*Example 8. (i) Facts.* Employer offers employee-only and SHOP dependent coverage through a QHP to its three employees using list billing. All three employees enroll in the employee-only coverage, and one employee elects to enroll two dependents in SHOP dependent coverage. Employer contributes 100% of the employee-only premium costs, but only contributes 25% of the premium costs toward SHOP dependent coverage.

(ii) *Conclusion.* Employer's contribution of 100% toward the premium costs of employee-only coverage satisfies the uniform percentage requirement, even though Employer is only contributing 25% toward SHOP dependent coverage.

*Example 9. (i) Facts.* Employer has five employees. Employer is located in a State that requires employers to pay 50% of employees' premium costs, but also requires that an employee's contribution not exceed a certain percentage of the employee's monthly gross earnings from that employer. Employer offers to pay 50% of the premium costs for all its employees, and to comply with the State law, Employer contributes more than 50% of the premium costs for two of its employees.

(ii) *Conclusion.* Employer satisfies the uniform percentage requirement because its failure to otherwise satisfy the uniform percentage requirement is attributable solely to compliance with the applicable State or local law.

*Example 10. (i) Facts.* Employer has three employees who all enroll in employee-only coverage. Employer is located in a State that has a tobacco surcharge on the premiums of employees who use tobacco. One of Employer's employees smokes. Employer contributes 50% of the employee-only premium costs, but does not cover any of the tobacco surcharge for the employee who smokes.

(ii) *Conclusion.* Employer's contribution of 50% toward the premium costs of employee-only coverage satisfies the uniform percentage requirement. Tobacco surcharges are not factored into premiums when calculating the uniform percentage requirement.

*Example 11. (i) Facts.* Employer has five employees who all enroll in employee-only coverage. Employer offers a wellness program that reduces the employee share of the premium for employees who participate in the wellness program. Employer contributes 50% of the premium costs of employee-only coverage for employees who do not participate in the wellness program and 55% of the premium costs of employee-only coverage for employees who participate in the wellness program. Three of the five employees participate in the wellness program.

(ii) *Conclusion.* Employer's contribution of 50% toward the premium costs of employee-only coverage for the two employees who do not participate in the wellness program and 55% toward the premium costs of employee-only coverage for three employees who participate in the wellness program satisfies the uniform percentage requirement because the additional 5% contribution due to the employees' participation in the wellness program is not taken into account. However, the additional 5% contributions are taken into account for purposes of calculating the credit.

(g) *Effective/applicability date.* This section is applicable for periods after 2013. For transition rules relating to certain plan years starting in 2014, see § 1.45R-3(i).

#### § 1.45R-5 Claiming the credit.

(a) *Claiming the credit.* The credit is a general business credit. It is claimed on an eligible small employer's annual income tax return and offsets an employer's actual tax liability for the year. The credit is claimed by attaching Form 8941, "Credit for Small Employer Health Insurance Premiums," to the eligible small employer's income tax return or, in the case of a tax-exempt eligible small employer, by attaching Form 8941 to the employer's Form 990-T, "Exempt Organization Business Income Tax Return." To claim the credit, a tax-exempt eligible small employer must file a form 990-T with an attached Form 8941, even if a Form 990-T would not otherwise be required to be filed.

(b) *Estimated tax payments and alternative minimum tax (AMT) liability.* An eligible small employer may reflect the credit in determining estimated tax payments for the year in which the credit applies in accordance with the estimated tax rules as set forth in sections 6654 and 6655 and the applicable regulations. An eligible small employer may also use the credit to offset the employer's alternative minimum tax (AMT) liability for the year, if any, subject to certain limitations based on the amount of the employer's regular tax liability, AMT liability and other allowable credits. See section 38(c)(1), as modified by section 38(c)(4)(B)(vi). However, an eligible small employer, including a tax-exempt eligible small employer, may not reduce its deposits and payments

of employment tax (that is, income tax required to be withheld under section 3402, social security and Medicare tax under sections 3101 and 3111, and federal unemployment tax under section 3301) during the year in anticipation of the credit.

(c) *Reduction of section 162 deduction.* No deduction under section 162 is allowed for the eligible small employer for that portion of the health insurance premiums that is equal to the amount of the credit under § 1.45R-2.

(d) *Effective/applicability date.* This section is applicable for periods after 2013. For rules relating to certain plan years beginning in 2014, see § 1.45R-3(i).

John Dalrymple  
Deputy Commissioner  
for Services and Enforcement.

Approved June 24, 2014,

Mark J. Mazur  
Assistant Secretary of the Treasury  
(Tax Policy).

(Filed by the Office of the Federal Register on, June 26, 2014, 4:15 p.m., and published in the issue of the Federal Register for June 30, 2014, 79 F.R. 36640)

## Section 401.—Qualified Pension, Profit-Sharing, and Stock Bonus Plans

26 CFR 1.401(a)(9): Required minimum distributions for defined benefit plans and annuity contracts.

TD 9673

### DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Parts 1 and 602

#### Longevity Annuity Contracts

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the use of lon-

gevity annuity contracts in tax-qualified defined contribution plans under section 401(a) of the Internal Revenue Code (Code), section 403(b) plans, individual retirement annuities and accounts (IRAs) under section 408, and eligible governmental plans under section 457(b). These regulations will provide the public with guidance necessary to comply with the required minimum distribution rules under section 401(a)(9) applicable to an IRA or a plan that holds a longevity annuity contract. The regulations will affect individuals for whom a longevity annuity contract is purchased under these plans and IRAs (and their beneficiaries), sponsors and administrators of these plans, trustees and custodians of these plans and IRAs, and insurance companies that issue longevity annuity contracts under these plans and IRAs.

*DATES: Effective date:* These regulations are effective on July 2, 2014.

*Applicability date:* These regulations apply to contracts purchased on or after July 2, 2014.

FOR FURTHER INFORMATION CONTACT: Jamie Dvoretzky at (202) 317-6799 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

#### Paperwork Reduction Act

The collection of information contained in these regulations has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) under control number 1545-2234. The collection of information in these final regulations is in A-17(a)(6) of § 1.401(a)(9)-6 (disclosure that a contract is intended to be a qualifying longevity annuity contract (QLAC), defined in A-17 of that section) and § 1.6047-2 (an annual statement must be provided to QLAC owners and their surviving spouses containing information required to be furnished to the IRS). The information in A-17(a)(6) of § 1.401(a)(9)-6 is required in order to notify employees<sup>1</sup> and beneficiaries, plan sponsors, and the IRS that the regulations apply to a contract. The infor-

<sup>1</sup>An "employee" includes the owner of an IRA, where applicable.

mation in the annual statement in § 1.6047-2(c) is required in order to apply the dollar and percentage limitations in A-17(b) of § 1.401(a)(9)-6 and A-12(b) of § 1.408-8 and to comply with other requirements of the required minimum distribution rules.

Estimated total average annual record-keeping burden: 28,529 hours.

Estimated average annual burden per response: 8 minutes.

Estimated number of responses: 213,966.

Estimated number of recordkeepers: 150.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid control number assigned by the Office of Management and Budget.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by section 6103.

## Background

This document contains amendments to the Income Tax Regulations (26 CFR part 1) under sections 401(a)(9), 403(b)(10), 408(a)(6), 408(b)(3), 408A(c)(5), and 6047(d) of the Code.

Section 401(a)(9) prescribes required minimum distribution rules for a qualified trust under section 401(a). In general, under these rules, distribution of each employee's entire interest must begin by the required beginning date. The required beginning date generally is April 1 of the calendar year following the later of (1) the calendar year in which the employee attains age 70½ or (2) the calendar year in which the employee retires. However, the ability to delay distribution until the calendar year in which an employee retires does not apply in the case of a 5-percent owner or an IRA owner.

If the entire interest of the employee is not distributed by the required beginning date, section 401(a)(9)(A) provides that the entire interest of the employee must be distributed, beginning not later than the required beginning date, in accordance with regulations, over the life of the employee or lives of the employee and a

designated beneficiary (or over a period not extending beyond the life expectancy of the employee or the life expectancy of the employee and a designated beneficiary). Section 401(a)(9)(B) prescribes required minimum distribution rules that apply after the death of the employee. Section 401(a)(9)(G) provides that any distribution required to satisfy the incidental death benefit requirement of section 401(a) is treated as a required minimum distribution.

Section 403(b) plans, IRAs described in section 408, and eligible deferred compensation plans under section 457(b) also are subject to the required minimum distribution rules of section 401(a)(9) pursuant to sections 403(b)(10), 408(a)(6) and (b)(3), and 457(d)(2), respectively, and to the regulations under those sections. However, pursuant to section 408A(c)(5), the minimum distribution and minimum distribution incidental benefit (MDIB) requirements do not apply to Roth IRAs during the life of the employee.

Section 6047(d) states that the Secretary shall by forms or regulations require the employer maintaining, or the plan administrator of, a plan from which designated distributions (as defined in section 3405(e)(1)) may be made, and any person issuing any contract under which designated distributions may be made, to make returns and reports regarding the plan or contract to the Secretary, to the participants and beneficiaries of the plan or contract, and to such other persons as the Secretary may by regulations prescribe. This section also provides that the Secretary may, by forms or regulations, prescribe the manner and time for filing these reports.

Section 1.401(a)(9)-6 of the Income Tax Regulations sets forth the minimum distribution rules that apply to a defined benefit plan and to annuity contracts under a defined contribution plan. Under A-12 of § 1.401(a)(9)-6, if an annuity contract held under a defined contribution plan has not yet been annuitized, the interest of an employee or beneficiary under that contract is treated as an individual account for purposes of section 401(a)(9). Thus, the value of that contract is included in the account balance used to determine required minimum distributions from the employee's individual account.

If an annuity contract has been annuitized, the periodic annuity payments must be nonincreasing, subject to certain exceptions that are set forth in A-14 of § 1.401(a)(9)-6. In addition, annuity payments must satisfy the MDIB requirement of section 401(a)(9)(G). Under A-2(b) of § 1.401(a)(9)-6, if an employee's sole beneficiary, as of the annuity starting date, is his or her spouse and the distributions satisfy section 401(a)(9) without regard to the MDIB requirement, the distributions to the employee are deemed to satisfy the MDIB requirement. However, if distributions are in the form of a joint and survivor annuity for an employee and a non-spouse beneficiary, the MDIB requirement is not satisfied unless the periodic annuity payment payable to the survivor does not exceed an applicable percentage of the amount that is payable to the employee, with the applicable percentage determined using the table in A-2(c) of § 1.401(a)(9)-6.

The regulations under sections 403(b)(10), 408(a)(6), 408(b)(3), 408A(c)(5), and 457(d)(2) prescribe how the required minimum distribution rules apply to other types of retirement plans and accounts. Section 1.403(b)-6(e)(2) provides, with certain exceptions, that the section 401(a)(9) required minimum distribution rules are applied to section 403(b) contracts in accordance with the provisions in § 1.408-8. As provided in A-1 of § 1.408-8, with certain modifications, an IRA is subject to the rules of §§ 1.401(a)(9)-1 through 1.401(a)(9)-9. One such modification is set forth in A-9 of § 1.408-8, which prescribes a rule under which an IRA generally does not fail to satisfy section 401(a)(9) merely because the required minimum distribution with respect to the IRA is distributed instead from another IRA.

On February 2, 2010, the Department of Labor, the IRS, and the Department of the Treasury issued a Request for Information Regarding Lifetime Income Options for Participants and Beneficiaries in Retirement Plans in the **Federal Register** (75 FR 5253). That Request for Information included questions relating to how the required minimum distribution rules affect defined contribution plan sponsors' and participants' interest in the offering and use of lifetime income products. In particular, the Request for Information

asked whether there were changes to the rules that could or should be considered to encourage arrangements under which participants can purchase deferred annuities that begin at an advanced age (sometimes referred to as longevity annuities or longevity insurance). A number of commenters identified the required minimum distribution rules as an impediment to the utilization of these types of annuities. The Treasury Department and the IRS concluded that there are substantial advantages to modifying the minimum distribution rules in order to facilitate a participant's purchase of a deferred annuity that is scheduled to commence at an advanced age, such as 80 or 85.

On February 3, 2012, proposed amendments to the regulations (REG-115809-11) under sections 401(a)(9), 403(b)(10), 408(a)(6), 408(b)(3), 408A(c)(5), and 6047(d) of the Code were published in the **Federal Register** (77 FR 5443). The amendments to the regulations relating to the required minimum distribution rules were proposed in order to facilitate the purchase of deferred annuities that begin at an advanced age.

A public hearing was held on June 1, 2012. Written comments responding to the notice of proposed rulemaking were also received. After consideration of all the comments, the proposed regulations are adopted, as amended by this Treasury Decision. The most significant revisions are discussed in the Summary of Comments and Explanation of Revisions.

### **Summary of Comments and Explanation of Revisions**

These final regulations modify the required minimum distribution rules in order to facilitate the purchase of deferred annuities that begin at an advanced age. These regulations apply to contracts that satisfy certain requirements, including the requirement that distributions commence not later than age 85. Prior to annuitization, the value of these contracts, referred to as "qualifying longevity annuity contracts" (QLACs), is excluded from the account balance used to determine required minimum distributions.

## **I. Definition of QLAC**

### **A. Limitations on premiums**

The proposed regulations provided that in order to constitute a QLAC, the amount of the premiums paid for the contract under the plan on a given date could not exceed the lesser of \$100,000 or 25 percent of the employee's account balance on the date of payment. If, on or before the date of a premium payment, an employee had paid premiums for the same contract or for any other contract that was intended to be a QLAC and that was purchased for the employee under the plan or under any other retirement plan, annuity, or account, the dollar limit would be reduced by the amount of those other premium payments. Similarly, if, on or before the date of a premium payment, an employee had paid premiums for the same contract or for any other contract that was intended to be a QLAC and that was purchased for the employee under the plan, the amount of those other premium payments will be taken into account in determining compliance with the percentage limit.

A number of commenters requested that the \$100,000 limit or the 25-percent limit (or both) be increased to allow individuals to obtain more longevity risk protection. Other commenters supported retention of the limits at their proposed levels.

The Treasury Department and the IRS continue to believe that a dollar limit and a percentage limit are necessary in order to constrain undue deferral of distribution of an employee's interest. Moreover, as noted in the preamble to the proposed regulations, a premium of \$100,000 could purchase an annuity that provides significant income beginning at age 85. For example, if at age 70 an employee used \$100,000 of his or her account balance to purchase an annuity that will commence at age 85, the annuity could provide an annual income that is estimated to range between \$26,000 and \$42,000 (depending on the actuarial assumptions used by the issuer and the form of the annuity elected by the employee).<sup>2</sup> In addition, providing special treatment to QLACs purchased with no more than 25 percent of the ac-

count balance is consistent with section 401(a)(9)(A) because, for a typical employee who will need to draw down the entire account balance during the period prior to commencement of the annuity, the overall pattern of payments from the account balance and the QLAC would not provide more deferral than would otherwise normally be available for lifetime payments under the section 401(a)(9)(A) rules.

After consideration of all of the comments, the Treasury Department and the IRS have concluded that the dollar limit on premiums under the proposed regulations can be increased to \$125,000 without leading to an unacceptable level of deferral of distribution. Accordingly, the final regulations increase the \$100,000 premium limit to \$125,000. The final regulations continue to provide that no more than 25 percent of the account balance may be used to pay premiums.

To simplify the application of the percentage limit, the final regulations clarify that the limit is applied with respect to an employee's account balance under a qualified plan as of the last valuation date preceding the date of a premium payment, increased for contributions allocated to the account (and decreased for distributions made from the account) after the valuation date but before the date the premium is paid. In addition, the final regulations clarify that although the value of a QLAC is excluded from the account balance used to determine required minimum distributions, the value of a QLAC is included in the account balance for purposes of applying the 25-percent limit.

The proposed regulations provided that if a premium for a contract causes the total premiums to exceed either the dollar or percentage limitation, the contract would fail to be a QLAC beginning on the date on which the excess premium was paid. A number of commenters requested that this rule be modified, stating that disqualifying an entire contract would be a harsh result, particularly in the case of an inadvertent error. They suggested that the regulations instead provide that if a premium for a longevity annuity contract exceeds the dollar or percentage limits, the QLAC will

<sup>2</sup>These illustrations assume a three-percent interest rate, no pre-annuity-starting-date death benefit, use of the Annuity 2000 Mortality Table for males and females, no indexation of the annuity stream for inflation, and no load for expenses. (If the annuity were provided under an employer plan, unisex mortality assumptions would be required.)

be disqualified (and hence included in the account balance used to calculate required minimum distributions) only to the extent of the excess premiums. Others suggested that there be a correction program that would allow employees to correct excess premiums.

In response to these comments, the final regulations provide that if an annuity contract fails to be a QLAC solely because premiums for the contract exceed the premium limits, then the contract will not fail to be a QLAC if the excess premium is returned to the non-QLAC portion of the employee's account by the end of the calendar year following the calendar year in which the excess premium was paid. The excess premium may be returned to the non-QLAC portion of the employee's account either in cash or in the form of an annuity contract that is not intended to be a QLAC. If the excess premium (including the fair market value of an annuity contract that is not intended to be a QLAC, if applicable) is returned to the non-QLAC portion of the employee's account after the last valuation date for the calendar year in which the excess premium was originally paid, then the employee's account balance as of that valuation date must be increased to reflect the excess premium. Any such return of excess premium will not be treated as a violation of the rule that a QLAC must not provide a commutation benefit.

In response to other comments, the final regulations clarify that if a contract at any time fails to be a QLAC for reasons other than exceeding the premium limitations, the contract will not be treated as a QLAC, or a contract that is intended to be a QLAC, beginning on the date of the first premium payment for that contract.

The proposed regulations provided that for calendar years beginning on or after the calendar year in which the regulations are effective, the dollar limitation would be adjusted at the same time and in the same manner as under section 415(d), except that (1) the base period would be the calendar year quarter beginning six months before the effective date of the regulations, and (2) any increase that is not a multiple of \$25,000 would be rounded to the next lowest multiple of \$25,000. In response to comments requesting that the dollar limit be adjusted

in smaller increments than \$25,000, the final regulations provide that any increase that is not a multiple of \$10,000 will be rounded to the next lowest multiple of \$10,000.

#### *B. Maximum age at commencement*

Like the proposed regulations, the final regulations provide that in order to constitute a QLAC, the contract must provide that distributions under the contract commence not later than a specified annuity starting date set forth in the contract. Under the final regulations, the specified annuity starting date must be no later than the first day of the month next following the employee's attainment of age 85. A QLAC could allow an employee to elect an earlier annuity starting date than the specified annuity starting date, but is not required to provide an option to commence distributions before the specified annuity starting date.

The final regulations continue to provide that the maximum age may be adjusted to reflect changes in mortality. The Treasury Department and the IRS anticipate that such changes will not occur more frequently than the adjustment of the \$125,000 limit described in subheading I.A. "Limitations on premiums." The adjusted age (if any) and the adjustment to the \$125,000 limit will be prescribed by the Commissioner in revenue rulings, notices, or other guidance published in the Internal Revenue Bulletin.

#### *C. Benefits payable after death of the employee*

The proposed regulations would have provided that under a QLAC the only benefit permitted to be paid after the employee's death is a life annuity, payable to a designated beneficiary, that meets certain requirements. Thus, for example, a contract that provides a distribution form with a period certain or a return of premiums in the case of an employee's death would not be a QLAC.

A number of commenters requested that QLACs be permitted to include a return of premium (ROP) feature that guarantees that if the annuitant dies before receiving payments at least equal to the total premiums paid under the contract, then an additional payment is made to ensure that the total payments received are at least equal to the total premiums paid under the contract. They noted that an

ROP feature would make QLACs more attractive by addressing the concerns of those who would be unwilling to take the risk that payments under the contract will not be at least equal to the premiums. Several commenters stated that although the cost of providing an ROP feature results in lower annuity payments, the effect would be relatively small and employees would still be more likely to choose an annuity with this feature than without it.

In response to these comments, the final regulations provide that a QLAC may offer an ROP feature that is payable before and after the employee's annuity starting date. Accordingly, a QLAC may provide for a single-sum death benefit paid to a beneficiary in an amount equal to the excess of the premium payments made with respect to the QLAC over the payments made to the employee under the QLAC. If a QLAC is providing a life annuity to a surviving spouse (or will provide a life annuity to a surviving spouse), it may also provide a similar ROP benefit after the death of both the employee and the spouse.

The final regulations provide that an ROP payment must be paid no later than the end of the calendar year following the calendar year in which the employee dies, or in which the surviving spouse dies, whichever is applicable. If the employee's death is after the required beginning date, then the ROP payment is treated as a required minimum distribution for the year in which it is paid and is not eligible for rollover. If the surviving spouse's death is after the required beginning date for the surviving spouse, then the ROP payment similarly is treated as a required minimum distribution for the year in which it is paid and is not eligible for rollover.

As under the proposed regulations, the final regulations provide that if the sole beneficiary of an employee under the contract is the employee's surviving spouse, the only benefit permitted to be paid after the employee's death (other than an ROP) is a life annuity payable to the surviving spouse that does not exceed 100 percent of the annuity payment payable to the employee. The final regulations also include a special exception that would allow a plan to comply with any applicable requirement to provide a qualified preretire-

ment survivor annuity.<sup>3</sup> If the surviving spouse is one of multiple designated beneficiaries, the special rules for a surviving spouse are permitted to be applied as if there were separate contracts for each of the separate beneficiaries, but only if certain conditions are satisfied, including a separate account requirement.<sup>4</sup>

If the employee's surviving spouse is not the sole beneficiary under the contract, the only benefit permitted to be paid after the employee's death (other than an ROP) is a life annuity payable to a designated beneficiary. In order to satisfy the MDIB requirements of section 401(a)(9)(G), the life annuity is not permitted to exceed an applicable percentage of the annuity payment payable to the employee. The applicable percentage is determined under one of two alternative tables, and the determination of which table applies depends on the different types of death benefits that are payable to the designated beneficiary. However, if the contract provides for an ROP, the applicable percentage is zero.

Under the first alternative table, the applicable percentage is the percentage described in the existing table in A-2(c) of § 1.401(a)(9)-6. This table is available only if, under the contract, no death benefits are payable to such a beneficiary if the employee dies before the specified annuity starting date. Furthermore, in order to address the possibility that an employee with a shortened life expectancy could accelerate the annuity starting date in order to circumvent this rule, this table is available only if, under the contract, no benefits are payable in any case in which the employee selects an annuity starting date that is earlier than the specified annuity starting date under the contract and dies less than 90 days after making that election, even if the employee's death occurs after his or her selected annuity starting date.

Under the second alternative table, the applicable percentage is the percentage described in a new table set forth in the final regulations. The table is available for use when the contract provides a pre-

annuity-starting-date death benefit to the non-spouse designated beneficiary. The table takes into account that a significant portion of the premium is used to provide death benefits to a designated beneficiary if death occurs during the deferral period between age 70½ and age 85. In order to limit the portion of the premium that is used to provide death benefits to a designated beneficiary, the proposed regulations provided that use of the table is limited to contracts under which any non-spouse designated beneficiary must be irrevocably selected as of the required beginning date. In response to comments, the final regulations modify this rule to allow the non-spouse beneficiary to be selected at a later date in certain circumstances, and to clarify that there is no violation of the irrevocability requirement that applies with respect to a non-spouse beneficiary if an employee substitutes his or her spouse as the beneficiary.

#### D. Other QLAC requirements

Under the proposed regulations, a QLAC would not include a variable contract under section 817 (variable annuity), an equity-indexed contract, or a similar contract. A number of commenters requested that variable annuities and annuities that base returns on an equity index be included in the definition of a QLAC. One commenter noted that a narrow definition may limit the demand for QLACs. Others noted that annuities that provide for equity exposure are better able to address the long-term risk of inflation than fixed annuities. The Treasury Department and the IRS believe that because the purpose of a QLAC is to provide an employee with a predictable stream of lifetime income a contract should be eligible for QLAC treatment only if the income under the contract is primarily derived from contractual guarantees. Because variable annuities and indexed contracts<sup>5</sup> provide a substantially unpredictable level of income to the employee, these contracts are inconsistent with the purpose of this regulation. This is true even if there is a minimum guaranteed income under those

contracts. In addition, having a limited set of easy-to-understand QLAC options available for purchase enhances the ability of employees to compare the products of multiple providers. Moreover, exposure to equity-based returns is available through control over the remaining portion of the account balance. Therefore, the final regulations provide that a QLAC does not include a variable contract under section 817, an indexed contract, or a similar contract. However, the final regulations also provide that the Commissioner may provide an exception to this rule in revenue rulings, notices, or other guidance published in the Internal Revenue Bulletin.

In response to comments, the final regulations clarify that a participating annuity contract is not treated as a contract that is similar to a variable contract or an indexed contract merely because it provides for the payment of dividends described in A-14(c)(3) of § 1.401(a)(9)-6. Similarly, a contract that provides for a cost-of-living adjustment described in A-14(b) of § 1.401(a)(9)-6 is not treated as a contract that is similar to a contract that is a variable contract or an indexed contract.

The proposed regulations also provided that in order to be a QLAC, a contract is not permitted to make available any commutation benefit, cash surrender value, or other similar feature. Although some commenters requested flexibility to offer contracts with these types of features, the final regulations retain this rule because the availability of such a feature would significantly reduce the benefit of mortality pooling under the contracts.

The proposed regulations provided that a contract is not a QLAC unless it states, when issued, that it is intended to be a QLAC. This rule would ensure that the issuer, employee, plan sponsor, and IRS know that the rules applicable to QLACs apply to a contract. Numerous commenters objected to this requirement, primarily because any changes to a contract form would require issuers to resubmit that form (even if it already satisfies the other QLAC requirements) to state insurance

<sup>3</sup>A qualified preretirement survivor annuity is defined in section 417(c)(2) as an annuity for the life of the surviving spouse, the actuarial equivalent of which is not less than 50 percent of the portion of the account balance of the participant (as of the date of death) to which the participant had a nonforfeitable right (within the meaning of section 411(a) of the Code). Section 205(e)(2) of the Employee Retirement Income Security Act of 1974, Public Law 93-406, as amended (ERISA), includes a parallel definition. See Rev. Rul. 2012-3, 2012-8 IRB 383 (2012) for rules relating to qualified preretirement survivor annuities.

<sup>4</sup>See A-2(a) and A-3 of § 1.401(a)(9)-8.

<sup>5</sup>Commenters indicated that an indexed contract and an equity-indexed contract are alternative names for the same type of annuity.

regulators for approval. Some commenters suggested that in order to alleviate the burden, issuers should be allowed to satisfy this requirement by including a statement in an insurance certificate or rider rather than in the contract itself. Several commenters suggested that the requirement to include this statement in the contract should be removed altogether because it duplicates the proposed disclosure requirement.

As under the proposed regulations, the final regulations provide that when the contract is issued an employee must be notified that the contract is intended to be a QLAC. However, in response to comments, the final regulations provide that this requirement will be satisfied if this language is included in the contract, or in a rider or endorsement with respect to the contract. The final regulations also provide that this requirement will be satisfied if a certificate is issued under a group annuity contract and the certificate, when issued, states that the employee's interest under the group annuity contract is intended to be a QLAC. In addition, the final regulations include a transition rule under which an annuity contract issued before January 1, 2016, will not fail to be a QLAC merely because the contract does not satisfy this requirement, provided that when the contract is issued the employee is notified that the contract (or a certificate under a group annuity contract) is intended to be a QLAC, and the contract is amended (or a rider, endorsement, or amendment to the certificate is issued) no later than December 31, 2016 to state that the contract is intended to be a QLAC.

The final regulations continue to provide that distributions under a QLAC must satisfy the generally applicable section 401(a)(9) requirements relating to annuities set forth in § 1.401(a)(9)-6, other than the requirement that annuity payments commence on or before the employee's required beginning date. Thus, for example, the limitation on increasing payments described in A-1(a) of § 1.401(a)(9)-6 applies to the contract.

## II. IRAs

The final regulations retain the premium limitations for IRAs provided under the proposed regulations. The final regulations provide that, in order to constitute a QLAC, the amount of the premiums paid for the contract under an IRA on a given date may not exceed \$125,000. If, on or before the date of a premium payment, an IRA owner has paid premiums for the same contract or for any other contract that is intended to be a QLAC under the IRA or under any other IRA, plan, or annuity, the \$125,000 limit is reduced by the amount of those other premium payments.

The final regulations also provide that, in order to constitute a QLAC the amount of the premiums paid for the contract under an IRA on a given date generally may not exceed 25 percent of the individual's IRA account balance. Consistent with the rule under which a required minimum distribution from an IRA could be satisfied by a distribution from another IRA (applied separately to traditional IRAs and Roth IRAs), the final regulations allow a QLAC that could be purchased under an IRA within these limitations to be purchased instead under another IRA. Specifically, the amount of the premiums paid for the contract under an IRA may not exceed an amount equal to 25 percent of the sum of the account balances (as of December 31 of the calendar year before the calendar year in which a premium is paid) of the IRAs (other than Roth IRAs) that an individual holds as the IRA owner. If, on or before the date of a premium payment, an individual has paid other premiums for the same contract or for any other contract that is intended to be a QLAC and that is held or purchased for the individual under his or her IRAs, the premium payment cannot exceed the amount determined to be 25 percent of the individual's IRA account balances, reduced by the amount of those other premiums.

Like the proposed regulations, the final regulations provide that for purposes of both the dollar and percentage limitations, unless the trustee, custodian, or issuer of

an IRA has actual knowledge to the contrary, the trustee, custodian, or issuer may rely on the IRA owner's representations of the amount of the premiums (other than the premiums paid under the IRA) and, for purposes of applying the percentage limitation, the amount of the individual's IRA account balances (other than the account balance under the IRA).

In light of the fact that Roth IRAs are not subject to the required minimum distribution rules prior to the death of the owner, the proposed regulations provided that an annuity purchased under a Roth IRA would not be treated as a QLAC. In addition, the dollar and percentage limitations on premiums that apply to a QLAC would not take into account premiums paid for a contract that is purchased or held under a Roth IRA, even if the contract satisfies the requirements to be a QLAC. If a QLAC is purchased or held under a plan, annuity, contract, or traditional IRA that is later rolled over or converted to a Roth IRA, the QLAC would cease to be a QLAC (and would cease to be treated as intended to be a QLAC) after the date of the rollover or conversion. In that case, the premiums would then be disregarded in applying the dollar and percentage limitations to premiums paid for other contracts after the date of the rollover or conversion.<sup>6</sup> The final regulations retain the proposed rules on Roth IRAs.

## III. Section 403(b) plans

As under the proposed regulations, the final regulations apply the tax-qualified plan rules, instead of the IRA rules, to the purchase of a QLAC under a section 403(b) plan. For example, the 25-percent limitation on premiums is separately determined for each section 403(b) plan in which an employee participates. The final regulations also provide that the tax-qualified plan rules relating to reliance on representations, rather than the IRA rules, apply to the purchase of a QLAC under a section 403(b) plan.

The final regulations also provide that, if the sole beneficiary of an employee under a contract is the employee's surviving spouse and the employee dies before

<sup>6</sup>See A-14 of § 1.408A-4 for a description of the amount includible in gross income when part or all of a traditional IRA that is an individual retirement annuity described in section 408(b) is converted to a Roth IRA, or when a traditional IRA that is an individual retirement account described in section 408(a) holds an annuity contract as an account asset and the traditional IRA is converted to a Roth IRA. Those rules would also apply when a contract is rolled over from a plan into a Roth IRA.

the annuity starting date under the contract, a life annuity that is payable to the surviving spouse after the employee's death is permitted to exceed the annuity that would have been payable to the employee to the extent necessary to satisfy the requirement to provide a qualified pre-retirement survivor annuity (as discussed for qualified plans under subheading I.C. "Benefits payable after death of the employee"). A section 403(b) plan may be subject to this requirement under ERISA, whereas IRAs are not subject to this requirement. See A-3(d) of § 1.401(a)-20 and § 1.403(b)-5(e).

#### IV. Section 457(b) plans

Section 1.457-6(d) provides that an eligible section 457(b) plan must meet the requirements of section 401(a)(9) and the regulations under section 401(a)(9). Thus, these regulations relating to the purchase of a QLAC under a tax-qualified defined contribution plan automatically apply to an eligible section 457(b) plan. However, the rule relating to QLACs is limited to eligible governmental plans under section 457(b). This is because section 457(b)(6) requires that an eligible section 457(b) plan that is not an eligible governmental plan be unfunded, and the purchase of an annuity contract under such a plan would be inconsistent with the requirement that such a plan be unfunded.

#### V. Defined benefit plans

A number of commenters favored allowing defined benefit plans to offer a QLAC. For example, several commenters stated that not permitting a QLAC to be offered under a defined benefit plan will encourage employees to roll over lump-sum distributions from defined benefit plans to defined contribution plans or IRAs, where they can buy a QLAC. They argued that it would be preferable for the annuities to be provided directly from a defined benefit plan.

Defined benefit plans generally are required to offer annuities, which provide

longevity protection. Because longevity protection is already available in these plans, the final regulations do not apply to defined benefit plans. However, the Treasury Department and the IRS request comments regarding the desirability of making a form of benefit that replicates the QLAC structure available in defined benefit plans. In particular the Treasury Department and the IRS request comments regarding the advantages to an employee of being able to elect a QLAC structure under a defined benefit plan, instead of electing a lump sum distribution from a defined benefit plan and rolling it over to a defined contribution plan or to an IRA in order to purchase a QLAC.

#### VI. Initial disclosure and annual reporting requirements

Under the proposed regulations, in addition to requiring the contract to state that it is intended to be a QLAC, the issuer of a QLAC would have been required to issue a disclosure containing certain information about the QLAC at the time of purchase. To avoid duplicating state law disclosure requirements, this initial disclosure would not have been required to include information that the issuer already provided to the employee in order to satisfy any applicable state disclosure law.

The final regulations do not require an initial disclosure to be issued to the employee in light of the existing disclosure practices that take into account disclosure requirements under state law and under Title I of ERISA.<sup>7</sup> If the Treasury Department and the IRS determine that employees are not receiving sufficient information before a QLAC is purchased, this issue may be reexamined.

As under the proposed regulations, the final regulations prescribe annual reporting requirements under section 6047(d) which require any person issuing any contract that is intended to be a QLAC to file annual calendar-year reports with the IRS and to provide a statement to the employee regarding the status of the contract. This reporting is necessary to inform both

plan administrators and employees that the contract is intended to be a QLAC, so that the dollar and percentage limitations applicable to QLACs can be applied, and to assist the IRS with the administration of the QLAC exception to the required minimum distribution rules. The report will be required to identify that the contract is intended to be a QLAC and to include, at a minimum, the following items of information:

- The name, address, and identifying number of the issuer of the contract, along with information on how to contact the issuer for more information about the contract;
- The name, address, and identifying number of the individual in whose name the contract has been purchased;
- If the contract was purchased under a plan, the name of the plan, the plan number, and the Employer Identification Number (EIN) of the plan sponsor;
- If payments have not yet commenced, the annuity starting date on which the annuity is scheduled to commence, the amount of the periodic annuity payable on that date, and whether that date may be accelerated;
- For the calendar year, the amount of each premium paid for the contract and the date of the premium payment;
- The total amount of all premiums paid for the contract through the end of the calendar year; and
- The fair market value of the QLAC as of the close of the calendar year.

The annual reporting requirement will be similar to the annual requirement to provide a Form 5498, "IRA Contribution Information," in the case of an IRA.<sup>8</sup> The Commissioner will prescribe a form and instructions for this purpose, which will contain the filing deadline and other information.

Each issuer required to file the report with respect to a contract will also be required to provide to the employee a statement containing the information that is required to be furnished in the report.

<sup>7</sup>See, for example, the Annuity Model Disclosure Regulation issued by the National Association of Insurance Commissioners and the disclosure for annuity contracts that are designated investment alternatives under 29 C.F.R. 2550.404a-5(i)(2).

<sup>8</sup>For an IRA, the fair market value of the account on December 31 must be provided to the IRA owner generally by January 31 of the following year, and to the IRS by a later date. Trustees, custodians, and issuers are responsible for ensuring that the fair market value of all IRA assets (including those not traded on an established securities market or with otherwise readily determinable value) is determined annually. This includes the fair market value of a contract that is intended to be a QLAC.

This requirement may be satisfied by providing the employee with a copy of the required form, or by providing the employee with the information in another document that contains the following language: "This information is being furnished to the Internal Revenue Service." The statement is required to be furnished to the employee on or before January 31 following the calendar year for which the report is required.

An issuer that is subject to these annual reporting requirements must comply with the requirements for each calendar year beginning with the year in which premiums are first paid and ending with the earlier of the year in which the employee attains age 85 (as adjusted in calendar years beginning after 2014) or dies. However, if the employee dies and the sole beneficiary under the contract is the employee's spouse (so that the spouse's annuity might not commence until the employee would have commenced benefits under the contract had the employee survived), the annual reporting requirement continues until the year in which the distributions to the spouse commence, or if earlier, the year in which the spouse dies. During this period, the annual statement must be provided to the surviving spouse.

#### **Effective/Applicability Dates**

These regulations apply to contracts purchased on or after July 2, 2014. One commenter requested that the regulations allow for annuities purchased before the regulations become final to convert to a QLAC in order to avoid surrender charges for contract reissuances, and prevent the absence of disclosure forms from delaying the benefit of these rules. If on or after July 2, 2014, an existing contract is exchanged for a contract that satisfies the requirements to be a QLAC, the new contract will be treated as purchased on the date of the exchange and therefore may qualify as a QLAC. In such a case the fair market value of the contract that is exchanged for a QLAC is treated as a premium that counts toward the QLAC limit.

#### **Availability of IRS Documents**

For copies of recently issued revenue procedures, revenue rulings, notices and other guidance published in the Internal Revenue Bulletin, please visit the IRS

Web site at <http://www.irs.gov> or contact the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402.

#### **Special Analyses**

It has been determined that these final regulations are not a significant regulatory action as defined in Executive Order 12866, as supplemented by Executive Order 13563. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. It is hereby certified that the collection of information in these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based upon the fact that the collection of information in these final regulations is in A-17(a)(6) of § 1.401(a)(9)-6 (disclosure that a contract is intended to be a QLAC) and § 1.6047-2 (an annual report must be filed with the IRS and a statement must be provided to QLAC owners and their surviving spouses). An insubstantial number of entities of any size will be impacted by the regulations, and the entities that will be impacted will be insurance companies, very few of which are small entities. In addition, IRS and Treasury expect that any burden on small entities will be minimal. Based on these facts, a regulatory flexibility analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Code, the notice of the proposed rulemaking preceding these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

#### **Drafting Information**

The principal authors of these regulations are Cathy Pastor and Jamie Dvoretzky, Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and the Treasury Department participated in the development of these regulations.

#### **List of Subjects**

##### **26 CFR Part 1**

Income taxes, reporting and recordkeeping requirements.

## **26 CFR Part 602**

Reporting and recordkeeping requirements.

### **Amendments to the Regulations**

Accordingly, 26 CFR parts 1 and 602 are amended as follows:

#### **Part 1—INCOME TAXES**

Paragraph 1. The authority citation for part 1 is amended by adding entries in numerical order to read in part as follows:

Authority: 26 U.S.C. 7805 \* \* \*

Section 1.6047-2 is also issued under 26 U.S.C. 6047(d). \* \* \*

Par. 2. Section 1.401(a)(9)-5 is amended by:

1. Revising paragraph A-3(a).
2. Redesignating paragraph A-3(d) as new paragraph A-3(e) and revising newly designated paragraph A-3(e).
3. Adding new paragraph A-3(d).

The revisions and addition read as follows:

##### *§ 1.401(a)(9)-5 Required minimum distributions from defined contribution plans.*

\* \* \* \* \*

A-3. (a) In the case of an individual account, the benefit used in determining the required minimum distribution for a distribution calendar year is the account balance as of the last valuation date in the calendar year immediately preceding that distribution calendar year (valuation calendar year) adjusted in accordance with paragraphs (b), (c), and (d) of this A-3.

\* \* \* \* \*

(d) The account balance does not include the value of any qualifying longevity annuity contract (QLAC), defined in A-17 of § 1.401(a)(9)-6, that is held under the plan. This paragraph (d) applies only to contracts purchased on or after July 2, 2014.

(e) If an amount is distributed from a plan and rolled over to another plan (receiving plan), A-2 of § 1.401(a)(9)-7 provides additional rules for determining the benefit and required minimum distribution under the receiving plan. If an amount is transferred from one plan (transferor plan) to another plan (transferee plan) in a transfer to which section 414(l) applies, A-3 and A-4 of § 1.401(a)(9)-7 provide addi-

tional rules for determining the amount of the required minimum distribution and the benefit under both the transferor and transferee plans.

\* \* \* \* \*

Par. 3. Section 1.401(a)(9)–6 is amended by revising the last sentence in A–12(a) and adding Q&A–17 to read as follows:

*§ 1.401(a)(9)–6 Required minimum distributions for defined benefit plans and annuity contracts.*

\* \* \* \* \*

A–12. (a) \* \* \* See A–1(e) of § 1.401(a)(9)–5 for rules relating to the satisfaction of section 401(a)(9) in the year that annuity payments commence, A–3(d) of § 1.401(a)(9)–5 for rules relating to qualifying longevity annuity contracts (QLACs), defined in A–17 of this section, and A–2(a)(3) of § 1.401(a)(9)–8 for rules relating to the purchase of an annuity contract with a portion of an employee’s account balance.

\* \* \* \* \*

Q–17. What is a qualifying longevity annuity contract?

A–17. (a) *Definition of qualifying longevity annuity contract.* A qualifying longevity annuity contract (QLAC) is an annuity contract that is purchased from an insurance company for an employee and that, in accordance with the rules of application of paragraph (d) of this A–17, satisfies each of the following requirements—

(1) Premiums for the contract satisfy the requirements of paragraph (b) of this A–17;

(2) The contract provides that distributions under the contract must commence not later than a specified annuity starting date that is no later than the first day of the month next following the 85<sup>th</sup> anniversary of the employee’s birth;

(3) The contract provides that, after distributions under the contract commence, those distributions must satisfy the requirements of this section (other than the requirement in A–1(c) of this section that annuity payments commence on or before the required beginning date);

(4) The contract does not make available any commutation benefit, cash surrender right, or other similar feature;

(5) No benefits are provided under the contract after the death of the employee other than the benefits described in paragraph (c) of this A–17;

(6) When the contract is issued, the contract (or a rider or endorsement with respect to that contract) states that the contract is intended to be a QLAC; and

(7) The contract is not a variable contract under section 817, an indexed contract, or a similar contract, except to the extent provided by the Commissioner in revenue rulings, notices, or other guidance published in the Internal Revenue Bulletin and made available by the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402 and on the IRS Web site at <http://www.irs.gov>.

(b) *Limitations on premiums—*(1) *In general.* The premiums paid with respect to the contract on a date satisfy the requirements of this paragraph (b) if they do not exceed the lesser of the dollar limitation in paragraph (b)(2) of this A–17 or the percentage limitation in paragraph (b)(3) of this A–17.

(2) *Dollar limitation.* The dollar limitation is an amount equal to the excess of—

(i) \$125,000 (as adjusted under paragraph (d)(2) of this A–17), over

(ii) The sum of—

(A) The premiums paid before that date with respect to the contract, and

(B) The premiums paid on or before that date with respect to any other contract that is intended to be a QLAC and that is purchased for the employee under the plan, or any other plan, annuity, or account described in section 401(a), 403(a), 403(b), or 408 or eligible governmental plan under section 457(b).

(3) *Percentage limitation.* The percentage limitation is an amount equal to the excess of—

(i) 25 percent of the employee’s account balance under the plan (including the value of any QLAC held under the plan for the employee) as of that date, determined in accordance with paragraph (d)(1)(iii) of this A–17, over

(ii) The sum of—

(A) The premiums paid before that date with respect to the contract, and

(B) The premiums paid on or before that date with respect to any other contract that is intended to be a QLAC and that is

held or was purchased for the employee under the plan.

(c) *Payments after death of the employee—*(1) *Surviving spouse is sole beneficiary—*(i) *Death on or after annuity starting date.* If the employee dies on or after the annuity starting date for the contract and the employee’s surviving spouse is the sole beneficiary under the contract then, except as provided in paragraph (c)(4) of this A–17, the only benefit permitted to be paid after the employee’s death is a life annuity payable to the surviving spouse where the periodic annuity payment is not in excess of 100 percent of the periodic annuity payment that is payable to the employee.

(ii) *Death before annuity starting date—*(A) *Amount of annuity.* If the employee dies before the annuity starting date and the employee’s surviving spouse is the sole beneficiary under the contract then, except as provided in paragraph (c)(4) of this A–17, the only benefit permitted to be paid after the employee’s death is a life annuity payable to the surviving spouse where the periodic annuity payment is not in excess of 100 percent of the periodic annuity payment that would have been payable to the employee as of the date that benefits to the surviving spouse commence. However, the annuity is permitted to exceed 100 percent of the periodic annuity payment that would have been payable to the employee to the extent necessary to satisfy the requirement to provide a qualified preretirement survivor annuity (as defined under section 417(c)(2) or ERISA section 205(e)(2)) pursuant to section 401(a)(11)(A)(ii) or ERISA section 205(a)(2).

(B) *Commencement date for annuity.* Any life annuity payable to the surviving spouse under paragraph (c)(1)(ii)(A) of this A–17 must commence no later than the date on which the annuity payable to the employee would have commenced under the contract if the employee had not died.

(2) *Surviving spouse is not sole beneficiary—*(i) *Death on or after annuity starting date.* If the employee dies on or after the annuity starting date for the contract and the employee’s surviving spouse is not the sole beneficiary under the contract then, except as provided in paragraph (c)(4) of this A–17, the only benefit per-

mitted to be paid after the employee's death is a life annuity payable to the designated beneficiary where the periodic annuity payment is not in excess of the applicable percentage (determined under paragraph (c)(2)(iii) of this A-17) of the periodic annuity payment that is payable to the employee.

(ii) *Death before annuity starting date*—(A) *Amount of annuity*. If the employee dies before the annuity starting date and the employee's surviving spouse is not the sole beneficiary under the contract then, except as provided in paragraph (c)(4) of this A-17, the only benefit permitted to be paid after the employee's death is a life annuity payable to the designated beneficiary where the periodic annuity payment is not in excess of the applicable percentage (determined under paragraph (c)(2)(iii) of this A-17) of the periodic annuity payment that would have been payable to the employee as of the date that benefits to the designated beneficiary commence under this paragraph (c)(2)(ii).

(B) *Commencement date for annuity*. In any case in which the employee dies before the annuity starting date, any life annuity payable to a designated beneficiary under this paragraph (c)(2)(ii) must commence by the last day of the calendar year immediately following the calendar year of the employee's death.

(iii) *Applicable percentage*—(A) *Contracts without pre-annuity starting date death benefits*. If, as described in paragraph (c)(2)(iv) of this A-17, the contract does not provide for a pre-annuity starting date non-spousal death benefit, the applicable percentage is the percentage described in the table in A-2(c) of this section.

(B) *Contracts with set beneficiary designation*. If the contract provides for a set non-spousal beneficiary designation as described in paragraph (c)(2)(v) (and is not a contract described in paragraph (c)(2)(iv)) of this A-17, the applicable percentage is the percentage described in the table set forth in paragraph (c)(2)(iii)(D) of this A-17. A contract is still considered to provide for a set beneficiary designation even if the surviving spouse becomes the sole beneficiary before the annuity starting date. In such a case, the requirements of paragraph (c)(1) of this A-17 apply and

not the requirements of this paragraph (c)(2).

(C) *Contracts providing for return of premium*. If the contract provides for a return of premium as described in paragraph (c)(4) of this A-17, the applicable percentage is 0.

(D) *Applicable percentage table*. The applicable percentage is based on the adjusted employee/beneficiary age difference, determined in the same manner as in A-2(c) of this section.

Adjusted employee/beneficiary age difference	Applicable percentage
2 years or less	100%
3	88%
4	78%
5	70%
6	63%
7	57%
8	52%
9	48%
10	44%
11	41%
12	38%
13	36%
14	34%
15	32%
16	30%
17	28%
18	27%
19	26%
20	25%
21	24%
22	23%
23	22%
24	21%
25 and greater	20%

(iv) *No pre-annuity starting date non-spousal death benefit*. A contract is described in this paragraph (c)(2)(iv) if the contract provides that no benefit is permitted to be paid to a beneficiary other than the employee's surviving spouse after the employee's death—

(A) In any case in which the employee dies before the annuity starting date under the contract; and

(B) In any case in which the employee selects an annuity starting date that is ear-

lier than the specified annuity starting date under the contract and the employee dies less than 90 days after making that election.

(v) *Contracts permitting set non-spousal beneficiary designation*. A contract is described in this paragraph (c)(2)(v) if the contract provides that if the beneficiary under the contract is not the employee's surviving spouse, benefits are payable to the beneficiary only if the beneficiary was irrevocably designated on or before the later of the date of purchase or the employee's required beginning date.

(3) *Calculation of early annuity payments*. For purposes of paragraphs (c)(1)(ii) and (c)(2)(ii) of this A-17, to the extent the contract does not provide an option for the employee to select an annuity starting date that is earlier than the date on which the annuity payable to the employee would have commenced under the contract if the employee had not died, the contract must provide a way to determine the periodic annuity payment that would have been payable if the employee were to have an option to accelerate the payments and the payments had commenced to the employee immediately prior to the date that benefit payments to the surviving spouse or designated beneficiary commence.

(4) *Return of premiums*—(i) *In general*. In lieu of a life annuity payable to a designated beneficiary under paragraph (c)(1) or (c)(2) of this A-17, a QLAC is permitted to provide for a benefit paid to a beneficiary after the death of the employee in an amount equal to the excess of—

(A) The premium payments made with respect to the QLAC over

(B) The payments already made under the QLAC.

(ii) *Payments after death of surviving spouse*. If a QLAC is providing a life annuity to a surviving spouse (or will provide a life annuity to a surviving spouse) under paragraph (c)(1) of this A-17, it is also permitted to provide for a benefit paid to a beneficiary after the death of both the employee and the spouse in an amount equal to the excess of—

(A) The premium payments made with respect to the QLAC over

(B) The payments already made under the QLAC.

(iii) *Other rules*—(A) *Timing of return of premium payment following death of employee*. A return of premium payment under this paragraph (c)(4) must be paid no later than the end of the calendar year following the calendar year in which the employee dies. If the employee's death is after the required beginning date, the return of premium payment is treated as a required minimum distribution for the year in which it is paid and is not eligible for rollover.

(B) *Timing of return of premium payment following death of surviving spouse receiving life annuity*. If the return of premium payment is paid after the death of a surviving spouse who is receiving a life annuity (or after the death of a surviving spouse who has not yet commenced receiving a life annuity after the death of the employee), the return of premium payment under this paragraph (c)(4) must be made no later than the end of the calendar year following the calendar year in which the surviving spouse dies. If the surviving spouse's death is after the required beginning date for the surviving spouse, then the return of premium payment is treated as a required minimum distribution for the year in which it is paid and is not eligible for rollover.

(5) *Multiple beneficiaries*. If an employee has more than one designated beneficiary under a QLAC, the rules in A-2(a) of § 1.401(a)(9)-8 apply for purposes of paragraphs (c)(1) and (c)(2) of this A-17.

(d) *Rules of application*—(1) *Rules relating to premiums*—(i) *Reliance on representations*. For purposes of the limitation on premiums described in paragraphs (b)(2) and (b)(3) of this A-17, unless the plan administrator has actual knowledge to the contrary, the plan administrator may rely on an employee's representation (made in writing or such other form as may be prescribed by the Commissioner) of the amount of the premiums described in paragraphs (b)(2)(ii)(B) and (b)(3)(ii)(B) of this A-17, but only with respect to premiums that are not paid under a plan, annuity, or contract that is maintained by the employer or an entity that is treated as a single employer with the employer under section 414(b), (c), (m), or (o).

(ii) *Consequences of excess premiums*—(A) *General Rule*. If an annuity contract fails to be a QLAC solely because a premium for the contract exceeds the limits under paragraph (b) of this A-17, then the contract is not a QLAC beginning on the date that premium payment is made unless the excess premium is returned to the non-QLAC portion of the employee's account in accordance with paragraph (d)(1)(ii)(B) of this A-17. If the contract fails to be a QLAC, then the value of the contract may not be disregarded under A-3(d) of § 1.401(a)(9)-5 as of the date on which the contract ceases to be a QLAC.

(B) *Correction in year following year of excess*. If the excess premium is returned (either in cash or in the form of a contract that is not intended to be a QLAC) to the non-QLAC portion of the employee's account by the end of the calendar year following the calendar year in which the excess premium was originally paid, then the contract will not be treated as exceeding the limits under paragraph (b) of this A-17 at any time, and the value of the contract will not be included in the employee's account balance under A-3(d) of § 1.401(a)(9)-5. If the excess premium (including the fair market value of an annuity contract that is not intended to be a QLAC, if applicable) is returned to the non-QLAC portion of the employee's account after the last valuation date for the calendar year in which the excess premium was originally paid, then the employee's account balance for that calendar year must be increased to reflect that excess premium in the same manner as an employee's account balance is increased under section 1.401(a)(9)-7, A-2 to reflect a rollover received after the last valuation date.

(C) *Return of excess premium not a commutation benefit*. If the excess premium is returned to the non-QLAC portion of the employee's account as described in paragraph (d)(1)(ii)(B) of this A-17, it will not be treated as a violation of the requirement in paragraph (a)(4) of this A-17 that the contract not provide a commutation benefit.

(iii) *Application of 25-percent limit*. For purposes of the 25-percent limit under paragraph (b)(3) of this A-17, an employee's account balance on the date on which

premiums for a contract are paid is the account balance as of the last valuation date preceding the date of the premium payment, adjusted as follows. The account balance is increased for contributions allocated to the account during the period that begins after the valuation date and ends before the date the premium is paid and decreased for distributions made from the account during that period.

(2) *Dollar and age limitations subject to adjustments*—(i) *Dollar limitation*. In the case of calendar years beginning on or after January 1, 2015, the \$125,000 amount under paragraph (b)(2)(i) of this A-17 will be adjusted at the same time and in the same manner as the limits are adjusted under section 415(d), except that the base period shall be the calendar quarter beginning July 1, 2013, and any increase under this paragraph (d)(2)(i) that is not a multiple of \$10,000 will be rounded to the next lowest multiple of \$10,000.

(ii) *Age limitation*. The maximum age set forth in paragraph (a)(2) of this A-17 may be adjusted to reflect changes in mortality, with any such adjusted age to be prescribed by the Commissioner in revenue rulings, notices, or other guidance published in the Internal Revenue Bulletin and made available by the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402 and on the IRS Web site at <http://www.irs.gov>.

(iii) *Prospective application of adjustments*. If a contract fails to be a QLAC because it does not satisfy the dollar limitation in paragraph (b)(2) of this A-17 or the age limitation in paragraph (a)(2) of this A-17, any subsequent adjustment that is made pursuant to paragraph (d)(2)(i) or paragraph (d)(2)(ii) of this A-17 will not cause the contract to become a QLAC.

(3) *Determination of whether contract is intended to be a QLAC*—(i) *Structural deficiency*. If a contract fails to be a QLAC at any time for a reason other than an excess premium described in paragraph (d)(1)(ii) of this A-17, then as of the date of purchase the contract will not be treated as a QLAC (for purposes of A-3(d) of § 1.401(a)(9)-5) or as a contract that is intended to be a QLAC (for purposes of paragraph (b) of this A-17) as of the date of purchase.

(ii) *Roth IRAs.* A contract that is purchased under a Roth IRA is not treated as a contract that is intended to be a QLAC for purposes of applying the dollar and percentage limitation rules in paragraphs (b)(2)(ii)(B) and (b)(3)(ii)(B) of this A-17. See A-14(d) of § 1.408A-6. If a QLAC is purchased or held under a plan, annuity, account, or traditional IRA, and that contract is later rolled over or converted to a Roth IRA, the contract is not treated as a contract that is intended to be a QLAC after the date of the rollover or conversion. Thus, premiums paid with respect to the contract will not be taken into account under paragraph (b)(2)(ii)(B) or paragraph (b)(3)(ii)(B) of this A-17 after the date of the rollover or conversion.

(4) *Certain contracts not treated as similar contracts—(i) Participating annuity contract.* An annuity contract is not treated as a contract described in paragraph (a)(7) of this A-17 merely because it provides for the payment of dividends described in A-14(c)(3) of § 1.401(a)(9)-6.

(ii) *Contracts with cost-of-living adjustments.* An annuity contract is not treated as a contract described in paragraph (a)(7) of this A-17 merely because it provides for a cost-of-living adjustment as described in A-14(b) of § 1.401(a)(9)-6.

(5) *Group annuity contract certificates.* The requirement under paragraph (a)(6) of this A-17 that the contract state that it is intended to be a QLAC when issued is satisfied if a certificate is issued under a group annuity contract and the certificate, when issued, states that the employee's interest under the group annuity contract is intended to be a QLAC.

(e) *Effective/applicability date—(1) General applicability date.* This A-17 and § 1.403(b)-6(e)(9) apply to contracts purchased on or after July 2, 2014. If on or after July 2, 2014, an existing contract is exchanged for a contract that satisfies the requirements of this A-17, the new contract will be treated as purchased on the date of the exchange and the fair market value of the contract that is exchanged for a QLAC will be treated as a premium paid with respect to the QLAC.

(2) *Delayed applicability date for requirement that contract state that it is intended to be QLAC.* An annuity contract

purchased before January 1, 2016, will not fail to be a QLAC merely because the contract does not satisfy the requirement of paragraph (a)(6) of this A-17, provided that—

(i) When the contract (or a certificate under a group annuity contract) is issued, the employee is notified that the annuity contract is intended to be a QLAC; and

(ii) The contract is amended (or a rider, endorsement or amendment to the certificate is issued) no later than December 31, 2016, to state that the annuity contract is intended to be a QLAC.

Par. 4. Section 1.403(b)-6 is amended by adding paragraph (e)(9) to read as follows:

§ 1.403(b)-6 *Timing of distributions and benefits.*

\* \* \* \* \*

(e) \* \* \*

(9) *Special rule for qualifying longevity annuity contracts.* The rules in A-17(b) of § 1.401(a)(9)-6 (relating to limitations on premiums for a qualifying longevity annuity contract (QLAC), defined in A-17 of § 1.401(a)(9)-6 and A-17(d)(1) of § 1.401(a)(9)-6 (relating to reliance on representations with respect to a QLAC) apply to the purchase of a QLAC under a section 403(b) plan (rather than the rules in A-12(b) and (c) of § 1.408-8).

\* \* \* \* \*

Par. 5. Section 1.408-8, Q&A-12, is added to read as follows:

§ 1.408-8 *Distribution requirements for individual retirement plans.*

\* \* \* \* \*

Q-12. How does the special rule in A-3(d) of § 1.401(a)(9)-5 for a qualifying longevity annuity contract (QLAC) apply to an IRA?

A-12. (a) *General rule.* The special rule in A-3(d) of § 1.401(a)(9)-5 for a QLAC, defined in A-17 of § 1.401(a)(9)-6, applies to an IRA, subject to the exceptions set forth in this A-12. See A-14(d) of § 1.408A-6 for special rules relating to Roth IRAs.

(b) *Limitations on premiums—(1) In general.* In lieu of the limitations described in A-17(b) of § 1.401(a)(9)-6, the

premiums paid with respect to the contract on a date are not permitted to exceed the lesser of the dollar limitation in paragraph (b)(2) of this A-12 or the percentage limitation in paragraph (b)(3) of this A-12.

(2) *Dollar limitation.* The dollar limitation is an amount equal to the excess of—

(i) \$125,000 (as adjusted under A-17(d)(2) of § 1.401(a)(9)-6), over

(ii) The sum of—

(A) The premiums paid before that date with respect to the contract, and

(B) The premiums paid on or before that date with respect to any other contract that is intended to be a QLAC and that is purchased for the IRA owner under the IRA, or any other plan, annuity, or account described in section 401(a), 403(a), 403(b), or 408 or eligible governmental plan under section 457(b).

(3) *Percentage limitation.* The percentage limitation is an amount equal to the excess of—

(i) 25 percent of the total account balances of the IRAs (other than Roth IRAs) that an individual holds as the IRA owner (including the value of any QLAC held under those IRAs) as of December 31 of the calendar year immediately preceding the calendar year in which a premium is paid, over

(ii) The sum of—

(A) The premiums paid before that date with respect to the contract, and

(B) The premiums paid on or before that date with respect to any other contract that is intended to be a QLAC and that is held or was purchased for the individual under those IRAs.

(c) *Reliance on representations.* For purposes of the limitations described in paragraphs (b)(2) and (b)(3) of this A-12, unless the trustee, custodian, or issuer of an IRA has actual knowledge to the contrary, the trustee, custodian, or issuer may rely on the IRA owner's representation (made in writing or such other form as may be prescribed by the Commissioner) of—

(1) The amount of the premiums described in paragraphs (b)(2)(ii)(B) and (b)(3)(ii)(B) of this A-12 that are not paid under the IRA, and

(2) The amount of the account balances described in paragraph (b)(3)(i) of this

A-12 (other than the account balance under the IRA).

(d) *Permitted delay in setting beneficiary designation.* In case of a contract that is rolled over from a plan to an IRA before the required beginning date under the plan, the contract will not violate the rule in A-17(c)(2)(v) of § 1.401(a)(9)-6 that a non-spouse beneficiary must be irrevocably selected on or before the later of the date of purchase or the required beginning date under the IRA, provided that the contract requires a beneficiary to be irrevocably selected by the end of the year following the year of the rollover.

(e) *Roth IRAs.* A contract that is purchased under a Roth IRA is not treated as a contract that is intended to be a QLAC for purposes of applying the dollar and percentage limitation rules in paragraphs (b)(2)(ii)(B) and (b)(3)(ii)(B) of this A-12. See A-14(d) of § 1.408A-6. If a QLAC is purchased or held under a plan, annuity, account, or traditional IRA, and that contract is later rolled over or converted to a Roth IRA, the contract is not treated as a contract that is intended to be a QLAC after the date of the rollover or conversion. Thus, premiums paid with respect to the contract will not be taken into account under paragraph (b)(2)(ii)(B) or paragraph (b)(3)(ii)(B) of this A-12 after the date of the rollover or conversion.

(f) *Effective/applicability date.* This A-12 applies to contracts purchased on or after July 2, 2014.

Par. 6. Section 1.408A-6 is amended by adding paragraph A-14(d) to read as follows:

*§ 1.408A-6 Distributions.*

\* \* \* \* \*

A-14. \* \* \*

(d) The special rules in A-3 of § 1.401(a)(9)-5 and A-12 of § 1.408-8 for a qualifying longevity annuity contract (QLAC), defined in A-17 of § 1.401(a)(9)-6, do not apply to a Roth IRA.

\* \* \* \* \*

Par. 7. Section 1.6047-2 is added to read as follows:

*§ 1.6047-2 Information relating to qualifying longevity annuity contracts.*

(a) *Requirement and form of report—*

(1) *In general.* Any person issuing any contract that is intended to be a qualifying longevity annuity contract (QLAC), defined in A-17 of § 1.401(a)(9)-6, shall make the report required by this section. This requirement applies only to contracts purchased or held under any plan, annuity, or account described in section 401(a), 403(a), 403(b), or 408 (other than a Roth IRA) or eligible governmental plan under section 457(b).

(2) *Annual report.* The issuer shall make annual calendar-year reports on the applicable form prescribed by the Commissioner for this purpose concerning the status of the contract. The report shall identify that the contract is intended to be a QLAC and shall contain the following information—

(i) The name, address, and identifying number of the issuer of the contract, along with information on how to contact the issuer for more information about the contract;

(ii) The name, address, and identifying number of the individual in whose name the contract has been purchased;

(iii) If the contract was purchased under a plan, the name of the plan, the plan number, and the Employer Identification Number (EIN) of the plan sponsor;

(iv) If payments have not yet commenced, the annuity starting date on which the annuity is scheduled to commence, the amount of the periodic annuity payable on that date, and whether that date may be accelerated;

(v) For the calendar year, the amount of each premium paid for the contract and the date of the premium payment;

(vi) The total amount of all premiums paid for the contract through the end of the calendar year;

(vii) The fair market value of the QLAC as of the close of the calendar year; and

(viii) Such other information as the Commissioner may require.

(b) *Manner and time for filing—*(1) *Timing.* The report required by paragraph (a)(2) of this section shall be filed in accordance with the forms and instructions prescribed by the Commissioner. Such a

report must be filed for each calendar year beginning with the year in which premiums for a contract are first paid and ending with the earlier of the year in which the individual in whose name the contract has been purchased attains age 85 (as adjusted pursuant to A-17(d)(2)(ii) of § 1.401(a)(9)-6) or dies.

(2) *Surviving spouse.* If the individual dies and the sole beneficiary under the contract is the individual's spouse (in which case the spouse's annuity would not be required to commence until the individual would have commenced benefits under the contract had the individual survived), the report must continue to be filed for each calendar year until the calendar year in which the distributions to the spouse commence or in which the spouse dies, if earlier.

(c) *Issuer statements.* Each issuer required to file the annual report required by paragraph (a)(2) of this section shall furnish to the individual in whose name the contract has been purchased a statement containing the information required to be included in the report, except that such statement shall be furnished to a surviving spouse to the extent that the report is required to be filed under paragraph (b)(2) of this section. A copy of the required form may be used to satisfy the statement requirement of this paragraph (c). If a copy of the required form is not used to satisfy the statement requirement of this paragraph (c), the statement shall contain the following language: "This information is being furnished to the Internal Revenue Service." The statement required by this paragraph (c) shall be furnished on or before January 31 following the calendar year for which the report required by paragraph (a)(2) of this section is required.

(d) *Penalty for failure to file report.* Section 6652(e) prescribes a penalty for failure to file the report required by paragraph (a)(2) of this section.

(e) *Effective/applicability date.* This section applies to contracts purchased on or after July 2, 2014.

**PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT**

Par. 8. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805 \* \* \*

Par. 9. In § 602.101, paragraph (b) is amended as follows:

1. The following entries are added in numerical order to the table to read as follows:

§ 602.101 OMB Control numbers.

\* \* \* \* \*  
(b) \* \* \*

CFR part or section where identified and described	Current OMB control no.
* * * * *	
1.401(a)(9)-6.....	1545-2234
* * * * *	
1.6047-2.....	1545-2234

John Dalrymple  
Deputy Commissioner for Services and Enforcement.

Approved June 27, 2014.

Mark J. Mazur  
Assistant Secretary of the Treasury  
(Tax Policy).

(Filed by the Office of the Federal Register on July 1, 2014, 8:45 a.m., and published in the issue of the Federal Register for July 2, 2014, 79 F.R. 37633)

## Section 501.—Exemption from tax on corporations, certain trusts, etc.

1.501(a)-1: Exemption from Taxation.

TD 9674

DEPARTMENT OF THE TREASURY  
Internal Revenue Service  
26 CFR Part 1

### Guidelines for the Streamlined Process of Applying for Recognition of Section 501(c)(3) Status

AGENCY: Internal Revenue Service (IRS), Treasury.

**ACTION:** Final and temporary regulations.

**SUMMARY:** This document contains final and temporary regulations that provide guidance to eligible organizations seeking recognition of tax-exempt status under section 501(c)(3) of the Internal Revenue Code (Code). The final and temporary regulations amend current regulations to allow the Commissioner of Internal Revenue to adopt a streamlined application process that eligible organizations may use to apply for recognition of tax-exempt status under section 501(c)(3). The text of the temporary regulations also serves as the text of the proposed regulations (REG-110948-14) set forth in the notice of proposed rulemaking on this subject in the Proposed Rules section in this issue of the **Bulletin**.

**DATES: Effective Date:** These regulations are effective on July 1, 2014.

**Applicability Date:** For dates of applicability, see §§ 1.501(a)-1T(f)(1), 1.501(c)(3)-1T(h)(1), 1.508-1T(c)(1).

#### FOR FURTHER INFORMATION

**CONTACT:** James R. Martin or Robin Ehrenberg at (202) 317-5800 (not a toll-free number).

#### SUPPLEMENTARY INFORMATION:

#### Background

Section 508 requires an organization seeking tax-exempt status under section 501(c)(3), as a condition of its exemption, to notify the Secretary of the Treasury (or his delegate) that it is applying for recognition of exempt status in the manner prescribed in the Treasury Regulations, unless it is specifically excepted from the requirement. Section 1.508-1(a) describes the process for giving notice, and requires that an organization “submit[ ] a properly completed and executed Form 1023, exemption application.” Section 1.501(c)(3)-1(b)(1)(v) states that an organization must, to establish its exemption, submit a detailed statement of its proposed activities with and as a part of its application for exemption. Similarly, § 1.501(a)-1(b)(1)(iii) provides that an organization described in section 501(c)(3) shall submit with, and as part of, an application, a detailed statement of its proposed activities. Section 1.501(a)-1(b)(2)

states that the Commissioner may require any additional information deemed necessary for a proper determination of whether a particular organization is exempt, and when deemed advisable in the interest of an efficient administration of the internal revenue laws, the Commissioner may, in the cases of particular types of organizations, prescribe the form in which the proof of exemption shall be furnished.

Detailed procedures for applying for recognition of exemption are set out in Rev. Proc. 2014-9, 2014-2 IRB 281, and in the instructions to Form 1023, “Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code.” See § 601.601(d)(2)(ii)(b) of this chapter.

#### Explanation of Provisions

The Treasury Department and the IRS have considered how the process of meeting the notice requirement of section 508 can be made more efficient for certain smaller organizations. The IRS is developing a streamlined form and process for these organizations. Accordingly, this Treasury decision amends §§ 1.501(a)-1, 1.501(c)(3)-1, and 1.508-1 to permit eligible organizations to use a streamlined process, described in guidance published in the Internal Revenue Bulletin, to meet the notice requirements of section 508.

Specifically, this Treasury decision amends §§ 1.501(a)-1 and 1.501(c)(3)-1 to authorize the Treasury Department and the IRS to prescribe, in applicable regulations or other guidance published in the Internal Revenue Bulletin, an exception to the requirement that an organization applying for tax-exempt status provide a detailed statement of its proposed activities. This document also amends the § 1.501(a)-1 provisions relating to the Commissioner’s ability to revoke a determination because of a change in the law or regulations, or for other good cause, to reference the Commissioner’s authority to retroactively revoke a determination under section 7805(b). No substantive change is intended by this amendment. This Treasury decision also amends the requirement in § 1.501(a)-1(b)(3) that an organization claiming to be exempted from filing annual returns file a statement supporting its claim with and as a part of its application. This amendment would

provide flexibility for the Treasury Department and the IRS to prescribe in published guidance other methods of notifying the IRS that the organization is claiming an annual filing exemption.

In addition, this document amends § 1.508-1 to provide that eligible organizations may use Form 1023-EZ, "Streamlined Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code," to notify the Commissioner of their applications for tax-exempt status under section 501(c)(3). This Treasury decision also amends §§ 1.501(a)-1 and 1.508-1 to state that the office to which applications should be submitted will be published in the Internal Revenue Bulletin or instructions to the Form 1023 or Form 1023-EZ.

Finally, this Treasury decision makes certain technical revisions to the regulations. In § 1.501(a)-1, the reference to "internal revenue district" is removed because such reference has been made obsolete by the enactment of the Internal Revenue Service Restructuring and Reform Act of 1998, Public Law 105-206, 112 Stat. 685. References to a district director in §§ 1.501(a)-1, 1.501(c)(3)-1, and 1.508-1 are also modified, as those positions no longer exist within the IRS. Proposed regulations in the Rules and Regulations section of this issue of the **Bulletin** use the text of these temporary regulations as the text of the proposed regulations. Treasury and the IRS seek comments on all aspects of the proposed rules, including whether additional technical revisions are necessary. Simultaneously with the publication of this Treasury decision, the Treasury Department and the IRS will release for publication a Revenue Procedure that provides procedures for applying for recognition of exemption using Form 1023-EZ.

### Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866, as supplemented by Executive Order 13563. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. For the applicability of the Regula-

tory Flexibility Act (5 U.S.C. chapter 6), refer to the Special Analyses section of the preamble to the cross-reference notice of proposed rulemaking published in the Proposed Rules section in this issue of the **Bulletin**. Pursuant to section 7805(f), these regulations have been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

### Drafting Information

The principal authors of these regulations are James R. Martin and Robin Ehrenberg of the Office of Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and the Treasury Department participated in their development.

\* \* \* \* \*

### Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

#### PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:  
Authority: 26 U.S.C. 7805 \* \* \*

Par. 2. Section 1.501(a)-1 is amended by:

1. Revising paragraphs (a)(2), (b)(1), and (b)(3).
2. Adding paragraph (f).

The revisions and addition read as follows:

#### § 1.501(a)-1 Exemption from taxation.

(a) \* \* \*  
(2) [Reserved]. For further guidance, see § 1.501(a)-1T(a)(2).

\* \* \* \* \*

(b)(1) [Reserved]. For further guidance, see § 1.501(a)-1T(b)(1).

\* \* \* \* \*

(3) [Reserved]. For further guidance, see § 1.501(a)-1T(b)(3).

\* \* \* \* \*

(f) [Reserved]. For further guidance, see § 1.501(a)-1T(f).

Par. 3. Section 1.501(a)-1T is added to read as follows:

#### § 1.501(a)-1T Exemption from taxation (temporary).

(a)(1) [Reserved]. For further guidance see § 1.501(a)-1(a)(1).

(2) An organization, other than an employees' trust described in section 401(a), is not exempt from tax merely because it is not organized and operated for profit. In order to establish its exemption, it is necessary that every such organization claiming exemption file an application form as set forth below with the appropriate office as designated by the Commissioner in guidance published in the Internal Revenue Bulletin, forms or instructions to the applicable forms. Subject only to the Commissioner's inherent power to revoke rulings, including with retroactive effect as permitted under section 7805(b), because of a change in the law or regulations or for other good cause, an organization that has been determined by the Commissioner (or previously by a district director) to be exempt under section 501(a) or the corresponding provision of prior law may rely upon such determination so long as there are no substantial changes in the organization's character, purposes, or methods of operation. An organization that has been determined to be exempt under the provisions of the Internal Revenue Code of 1939 or prior law is not required to secure a new determination of exemption merely because of the enactment of the Internal Revenue Code of 1954 unless affected by substantive changes in law made by such Code.

(3) [Reserved]. For further guidance, see § 1.501(a)-1(a)(3).

(b) *Additional proof by particular classes of organizations.* (1) Unless otherwise prescribed by applicable regulations or other guidance published in the Internal Revenue Bulletin, organizations mentioned below shall submit with and as a part of their applications the following information:

(i) Mutual insurance companies shall submit copies of the policies or certificates of membership issued by them.

(ii) In the case of title holding companies described in section 501(c)(2), if the organization for which title is held has not been specifically notified in writing by the Internal Revenue Service that it is held to be exempt under section 501(a), the title

holding company shall submit the information indicated herein as necessary for a determination of the status of the organization for which title is held.

(iii) An organization described in section 501(c)(3) shall submit with, and as a part of, an application filed after July 26, 1959, a detailed statement of its proposed activities.

(2) [Reserved]. For further guidance, see § 1.501(a)-1(b)(2).

(3) An organization claiming to be specifically exempted by section 6033(a) from filing annual returns shall submit with and as a part of its application (or in such other manner as is prescribed in guidance published in the Internal Revenue Bulletin) a statement of all the facts on which it bases its claim.

(c) through (e) [Reserved]. For further guidance, see § 1.501(a)-1(c) through (e).

(f) *Effective/applicability date.* (1) Paragraphs (a)(2), (b)(1), and (b)(3) of this section apply on and after July 1, 2014.

(2) *Expiration date.* Paragraphs (a)(2), (b)(1), and (b)(3) of this section expire on or before June 30, 2017.

Par. 4. Section 1.501(c)(3)-1 is amended by:

1. Revising paragraphs (b)(1)(v) and (b)(6).

2. Adding paragraph (h).

The revisions and addition read as follows:

*§ 1.501(c)(3)-1 Organizations organized and operated for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals.*

\* \* \* \* \*

(b) \* \* \* (1) \* \* \*

(v) [Reserved]. For further guidance see § 1.501(c)(3)-1T(b)(1)(v).

\* \* \* \* \*

(6) [Reserved]. For further guidance see § 1.501(c)(3)-1T(b)(6).

\* \* \* \* \*

(h) [Reserved]. For further guidance see § 1.501(c)(3)-1T(h).

Par. 5. Section 1.501(c)(3)-1T is added to read as follows:

*§ 1.501(c)(3)-1T Organizations organized and operated for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals (temporary).*

(a) through (b)(1)(iv) [Reserved]. For further guidance see § 1.501(c)(3)-1(a) through (b)(1)(iv).

(v) Unless otherwise prescribed by applicable regulations or other guidance published in the Internal Revenue Bulletin, an organization must, in order to establish its exemption, submit a detailed statement of its proposed activities with and as a part of its application for exemption (see paragraph (b) of § 1.501(a)-1).

(b)(2) through (b)(5) [Reserved]. For further guidance see § 1.501(c)(3)-1(b)(2) through (b)(5).

(6) *Applicability of the organizational test.* A determination by the Commissioner that an organization is described in section 501(c)(3) and exempt under section 501(a) will not be granted after July 26, 1959, regardless of when the application is filed, unless such organization meets the organizational test prescribed by this paragraph (b)(6). If, before July 27, 1959, an organization has been determined by the Commissioner or district director to be exempt as an organization described in section 501(c)(3) or in a corresponding provision of prior law and such determination has not been revoked before such date, the fact that such organization does not meet the organizational test prescribed by this paragraph (b)(6) shall not be a basis for revoking such determination. Accordingly, an organization that has been determined to be exempt before July 27, 1959, and which does not seek a new determination of exemption is not required to amend its articles of organization to conform to the rules of this paragraph (b)(6), but any organization that seeks a determination of exemption after July 26, 1959, must have articles of organization that meet the rules of this paragraph (b)(6). For the rules relating to whether an organization determined to be exempt before July 27, 1959, is organized exclusively for one or more exempt purposes, see 26 CFR (1939) 39.101(6)-1 (Regulations 118) as made applicable to the Code by Treasury Deci-

sion 6091, approved August 16, 1954 (19 FR 5167; CB 1954-2, 47).

(c) through (g) [Reserved]. For further guidance, see § 1.501(c)(3)-1(c) through (g).

(h) *Effective/applicability date.* (1) Paragraphs (b)(1)(v) and (b)(6) of this section apply on and after July 1, 2014.

(2) *Expiration date.* Paragraphs (b)(1)(v) and (b)(6) of this section expire on or before June 30, 2017.

Par. 6. Section 1.508-1 is amended by:

1. Revising paragraphs (a)(2)(i) and (a)(2)(ii).

2. Revising paragraphs (b)(2)(iv) and (b)(2)(v).

3. Adding paragraph (c).

The revisions and addition read as follows:

*§ 1.508-1 Notices.*

(a) \* \* \*

(2)(i) [Reserved]. For further guidance, see § 1.508-1T(a)(2)(i).

(ii) [Reserved]. For further guidance, see § 1.508-1T(a)(2)(ii).

\* \* \* \* \*

(b) \* \* \*

(2) \* \* \*

(iv) [Reserved]. For further guidance, see § 1.508-1T(b)(2)(iv).

(v) [Reserved]. For further guidance, see § 1.508-1T(b)(2)(v).

\* \* \* \* \*

(c) [Reserved]. For further guidance, see § 1.508-1T(c).

Par. 7. Section 1.508-1T is revised to read as follows:

*§ 1.508-1T Notices (temporary).*

(a)(1) [Reserved]. For further guidance, see § 1.508-1(a)(1).

(2) *Filing of notice.* (i) For purposes of paragraph (a)(1) of this section, except as provided in paragraph (a)(3) of this section, an organization seeking exemption under section 501(c)(3) must file the notice described in section 508(a) within 15 months from the end of the month in which the organization was organized, or before March 22, 1973, whichever comes later. Such notice is filed by submitting a properly completed and executed Form 1023 (or if applicable, Form 1023-EZ), exemption application. Notice should be

filed with the appropriate office as designated by the Commissioner in guidance published in the Internal Revenue Bulletin, forms or instructions to the applicable forms. A request for extension of time for the filing of such notice should be submitted to such appropriate office. Such request may be granted if it demonstrates that additional time is required.

(ii) Although the information required by either Form 1023 or Form 1023-EZ must be submitted to satisfy the notice required by this section, the failure to supply, within the required time, all of the information required to complete such form is not alone sufficient to deny exemption from the date of organization to the date such complete information for such form is submitted by the organization. If the information that is submitted within the required time is incomplete, and the organization supplies the necessary additional information at the request of the Commissioner within the additional time period allowed by him, the original notice will be considered timely.

(iii) through (b)(2)(iii) [Reserved]. For further guidance, see § 1.508-1(a)(2)(iii) through (b)(2)(iii).

(iv) Any organization filing notice under this paragraph (b)(2)(iv) that has not received a ruling or determination letter from the Internal Revenue Service dated on or before July 13, 1970, recognizing its exemption from taxation under section

501(c)(3) (or the corresponding provisions of prior law), shall file its notice by submitting a properly completed and executed Form 1023 (or if applicable, Form 1023-EZ) and providing information that it is not a private foundation. The organization shall also submit all information required by the regulations under section 170 or 509 (whichever is applicable) necessary to establish recognition of its classification as an organization described in section 509(a)(1), (2), (3), or (4). A Form 1023 submitted prior to July 14, 1970, will satisfy this requirement if the organization submits an additional statement that it is not a private foundation together with all pertinent additional information required. Any statement filed under this paragraph (b)(2)(iv) shall be accompanied by a written declaration by the principal officer, manager or authorized trustee that there is a reasonable basis in law and in fact for the statement that the organization so filing is not a private foundation, and that to the best of the knowledge and belief of such officer, manager or trustee, the information submitted is complete and correct.

(v) The notice filed under paragraph (b)(2)(ii) of this section should be filed in accordance with the instructions applicable to Form 4653. The notice required by paragraph (b)(2)(iv) of this section should be filed with the appropriate office as designated by the Commissioner in guidance

published in the Internal Revenue Bulletin, forms, or instructions to the applicable forms. An extension of time for the filing of such notice may be granted by such office upon timely request by the organization, if the organization demonstrates that additional time is required.

(b)(3) through (b)(8) [Reserved]. For further guidance, see § 1.508-1(b)(3) through (b)(8).

(c) *Effective/applicability date.* (1) Paragraphs (a)(2)(i), (a)(2)(ii), (b)(2)(iv), and (b)(2)(v) of this section apply on and after July 1, 2014.

(2) *Expiration date.* Paragraphs (a)(2)(i), (a)(2)(ii), (b)(2)(iv), and (b)(2)(v) of this section expire on or before June 30, 2017.

John Dalrymple,  
*Deputy Commissioner for  
Services and Enforcement.*

Approved June 27, 2014.

Mark J. Mazur,  
*Assistant Secretary of the Treasury  
(Tax Policy).*

(Filed by the Office of the Federal Register on July 1, 2014, 8:45 a.m., and published in the issue of the Federal Register for July 2, 2014, 79 F.R. 37630)

# Part III. Administrative, Procedural, and Miscellaneous

26 CFR 1.501(a)-1 Exemption from Taxation

26 CFR 1.508-1 Notices

## Rev. Proc. 2014-40

### TABLE OF CONTENTS

<b>SECTION 1. PURPOSE</b> .....	230
.01 Description of terms used in this revenue procedure.....	230
<b>SECTION 2. ELIGIBILITY</b> .....	230
.01 Organizations not eligible to submit Form 1023-EZ.....	230
.02 Terrorist organizations.....	231
<b>SECTION 3. RELATED REVENUE PROCEDURES AND EFFECT ON OTHER REVENUE PROCEDURES</b> .....	231
.01 Revenue Procedure 2014-9.....	231
.02 Revenue Procedure 2014-10.....	231
.03 Revenue Procedure 2014-8.....	232
.04 Revenue Procedure 2014-4.....	232
.05 Revenue Procedure 2014-5.....	232
.06 Revenue Procedure 2014-11.....	232
.07 References inclusive of annual successor revenue procedures.....	232
<b>SECTION 4. PROCEDURES FOR REQUESTING RECOGNITION OF EXEMPT STATUS UNDER § 501(c)(3)</b> .....	232
.01 In general.....	232
.02 Application.....	232
.03 User fee.....	232
.04 Method of submission.....	232
.05 Requirements for a completed Form 1023-EZ.....	232
.06 Form 1023-EZ from an organization with a pending Form 1023.....	233
.07 No expedited handling.....	233
<b>SECTION 5. STANDARDS FOR ISSUING A DETERMINATION LETTER ON EXEMPT STATUS UNDER § 501(c)(3)</b> .....	233
.01 In general.....	233
.02 Non-acceptance of Forms 1023-EZ.....	233
.03 Additional information may be required.....	233
.04 Issuance of determination letter.....	234
.05 Proposed adverse determination letters and appeal procedure.....	234
.06 Requests for technical advice.....	234
.07 Withdrawal of a Form 1023-EZ.....	234
<b>SECTION 6. DECLARATORY JUDGMENT PROVISIONS OF § 7428</b> .....	234
.01 General description.....	234
.02 Exhaustion of administrative remedies.....	234
.03 Service must have reasonable time to act on an appeal.....	235
.04 Exhaustion of administrative remedies no earlier than 270 days after seeking determination and taking all reasonable steps to secure a determination letter.....	235
.05 Final determination to which § 7428 applies.....	235
.06 Treatment of withdrawals and non-accepted applications.....	235
<b>SECTION 7. DISCLOSURE OF APPLICATIONS AND DETERMINATION LETTERS</b> .....	235
.01 Disclosure of favorable determinations.....	235
.02 Disclosure of adverse determinations.....	236
.03 Disclosure to state officials.....	236
<b>SECTION 8. EFFECT OF DETERMINATION LETTER RECOGNIZING EXEMPTION</b> .....	236
.01 Effective date of exemption.....	236
.02 Reliance on determination letter.....	236

.03 Automatic revocation.....	237
.04 Filing requirement.....	237
<b>SECTION 9. REVOCATION OR MODIFICATION OF DETERMINATION LETTER</b>	
<b>RECOGNIZING EXEMPTION</b> .....	237
.01 In general .....	237
.02 Retroactive revocation or modification.....	237
.03 Appeal and conference procedures .....	237
<b>SECTION 10. EFFECTIVE DATE</b> .....	238
<b>SECTION 11. DRAFTING INFORMATION</b> .....	238
<b>SECTION 12. PAPERWORK REDUCTION ACT</b> .....	238
<b>SECTION 13. REQUEST FOR COMMENTS</b> .....	238

**SECTION 1. PURPOSE**

This revenue procedure sets forth procedures for applying for and for issuing determination letters on the exempt status under § 501(c)(3) of the Internal Revenue Code (Code) using Form 1023–EZ, *Streamlined Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code*. This revenue procedure is generally available for certain U.S. organizations with assets of \$250,000 or less and annual gross receipts of \$50,000 or less.

.01 For purposes of this revenue procedure –

- (1) The “Service” means the Internal Revenue Service.
- (2) An “eligible organization” is an organization that is eligible to submit Form 1023–EZ. U.S. organizations with both assets valued at \$250,000 or less and annual gross receipts of \$50,000 or less may submit Form 1023–EZ unless the organization is designated in section 2 as an organization that is not eligible to submit Form 1023–EZ.
- (3) “EO Determinations” means the office of the Service that is primarily responsible for processing applications for tax-exempt status. It includes the main EO Determinations office located in Cincinnati, Ohio, and other field offices that are under the direction and control of the Director, EO Rulings and Agreements. Applications are generally processed in the centralized EO Determinations office in Cincinnati, Ohio. However, some applications may be processed in other EO Determinations offices.
- (4) “Appeals Office” means any office under the direction and control of the Chief, Appeals. The purpose of the Appeals Office is to resolve tax controversies, without litigation, on a fair and impartial basis. The Appeals office is independent of EO Determinations.
- (5) A “determination letter” means a written statement issued by EO Determinations or an Appeals Office in response to an application for recognition of exemption from Federal income tax under § 501. This includes a written statement issued by EO Determinations or an Appeals Office on the basis of technical advice pursuant to the procedures prescribed in Rev. Proc. 2014–5, 2014–1 I.R.B. 169.
- (6) “Form 1023–EZ” means the Form 1023–EZ, *Streamlined Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code*, which is the application used by eligible organizations to apply for recognition of exemption under § 501(c)(3) pursuant to this revenue procedure.
- (7) “Form 1023” means the Form 1023, *Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code*, which is the application used to apply for recognition of exemption under § 501(c)(3) pursuant to Rev. Proc. 2014–9, 2014–2 I.R.B. 281.

**SECTION 2. ELIGIBILITY**

.01 The following organizations are not eligible organizations and must use Form 1023 to apply for recognition of exemption under § 501(c)(3):

- (1) Organizations with projected annual gross receipts of more than \$50,000 in either the current taxable year or the next 2 years.
- (2) Organizations with annual gross receipts that have exceeded \$50,000 in any of the past 3 years.
- (3) Organizations with total assets the fair market value of which is in excess of \$250,000. For purposes of this eligibility requirement, a good faith estimate of the fair market value of the organization’s assets is sufficient.

- (4) Organizations formed under the laws of a foreign country (United States territories and possessions are not considered foreign countries).
- (5) Organizations that do not have a mailing address in the United States (territories and possessions are considered the United States for this purpose).
- (6) Organizations that are successors to, or controlled by, an entity suspended under § 501(p) (suspension of tax-exempt status of terrorist organizations).
- (7) Organizations that are not corporations, unincorporated associations, or trusts.
- (8) Organizations that are successors to a for-profit entity.
- (9) Organizations that were previously revoked or that are successors to a previously revoked organization (other than an organization the tax-exempt status of which was automatically revoked for failure to file a Form 990 series return or notice for three consecutive years).
- (10) Churches or conventions or associations of churches described in § 170(b)(1)(A)(i).
- (11) Schools, colleges, or universities described in § 170(b)(1)(A)(ii).
- (12) Hospitals or medical research organizations described in § 170(b)(1)(A)(iii) or § 501(r)(2)(A)(i). Cooperative hospital service organizations described in § 501(e).
- (13) Cooperative service organizations of operating educational organizations described in § 501(f).
- (14) Qualified charitable risk pools described in § 501(n).
- (15) Supporting organizations described in § 509(a)(3).
- (16) Organizations that have as a substantial purpose providing assistance to individuals through credit counseling activities such as budgeting, personal finance, financial literacy, mortgage foreclosure assistance, or other consumer credit areas.
- (17) Organizations that invest, or intend to invest, 5 percent or more of their total assets in securities or funds that are not publicly traded.
- (18) Organizations that participate, or intend to participate, in partnerships (including entities or arrangements treated as partnerships for Federal tax purposes) in which they share profits and losses with partners other than § 501(c)(3) organizations.
- (19) Organizations that sell, or intend to sell, carbon credits or carbon offsets.
- (20) Health Maintenance Organizations (HMOs).
- (21) Accountable Care Organizations (ACOs), or organizations that engage in, or intend to engage in, ACO activities (such as participation in the Medicare Shared Savings Program (MSSP) or in activities unrelated to the MSSP described in Notice 2011–20, 2011–16 I.R.B. 652).
- (22) Organizations that maintain, or intend to maintain, one or more donor advised funds.
- (23) Organizations that are organized and operated exclusively for testing for public safety and that are requesting a foundation classification under § 509(a)(4).
- (24) Private operating foundations.
- (25) Organizations that are applying for retroactive reinstatement of exemption under sections 5 or 6 of Rev. Proc. 2014–11, 2014–3 I.R.B. 411, after being automatically revoked.

Further information regarding these eligibility requirements may be provided in the *Instructions for Form 1023-EZ*.

.02 *Terrorist organizations.* An organization that is identified or designated as a terrorist organization within the meaning of § 501(p)(2) is not eligible to apply for recognition of exemption.

### **SECTION 3. RELATED REVENUE PROCEDURES AND EFFECT ON OTHER REVENUE PROCEDURES**

.01 Rev. Proc. 2014–9, 2014–2 I.R.B. 281, sets forth procedures for issuing determination letters and rulings on the exempt status of organizations under §§ 501 and 521. Those procedures do not apply to determination letters issued under this revenue procedure except to the extent specifically noted herein. This revenue procedure amplifies Rev. Proc. 2014–9 by providing alternative application and processing procedures for Form 1023–EZ, which may be used by eligible organizations seeking recognition of exemption under § 501(c)(3).

.02 Rev. Proc. 2014–10, 2014–2 I.R.B. 293, sets forth procedures for issuing rulings and determination letters on private foundation status under § 509(a). This revenue procedure amplifies Rev. Proc. 2014–10 by providing that the private foundation status of an organization may be determined when an eligible organization submits a Form 1023–EZ.

.03 Rev. Proc. 2014–8, 2014–1 I.R.B. 242, sets forth user fees for requests for a determination letter. This revenue procedure supplements Rev. Proc. 2014–8 by establishing the user fee for submitting a Form 1023–EZ pursuant to this revenue procedure.

.04 Rev. Proc. 2014–4, 2014–1 I.R.B. 125, sets forth procedures regarding the Service’s provision of guidance to taxpayers on issues under the jurisdiction of the Commissioner, Tax Exempt and Government Entities Division. This revenue procedure amplifies Rev. Proc. 2014–4 by providing that EO Determinations may also issue determination letters on initial qualification for exempt status of organizations described in § 501(c)(3) that applied using Form 1023–EZ, in accordance with this revenue procedure.

.05 Rev. Proc. 2014–5, 2014–1 I.R.B. 169, sets forth procedures regarding the issuance of technical advice in exempt organizations matters. This revenue procedure amplifies Rev. Proc. 2014–5 by providing that technical advice may also be sought and issued in the circumstances described in this revenue procedure.

.06 Rev. Proc. 2014–11, 2014–3 I.R.B. 411, sets forth procedures for reinstating the tax-exempt status of organizations that have had their tax-exempt status automatically revoked under § 6033(j)(1). This revenue procedure amplifies Rev. Proc. 2014–11 by providing that eligible organizations may apply for reinstatement under Rev. Proc. 2014–11 by submitting a Form 1023–EZ instead of a Form 1023. Form 1023–EZ is considered to be an “Application” within the meaning of section 2.01(1) of Rev. Proc. 2014–11.

.07 Any reference herein to an annual revenue procedure listed in sections 3.01 through 3.05 also refers to any successor to that revenue procedure.

**SECTION 4.  
PROCEDURES FOR  
REQUESTING  
RECOGNITION OF  
EXEMPT STATUS UNDER  
§ 501(c)(3)**

.01 *In general.* Unless subject to a specific exception, all organizations seeking tax-exempt status under § 501(c)(3) must, as a condition of exemption, apply for recognition of exempt status with the Service. An eligible organization may, but is not required to, seek recognition of tax-exempt status under § 501(c)(3) by submitting a Form 1023–EZ in accordance with this revenue procedure. Alternatively, an eligible organization may follow the procedures in Rev. Proc. 2014–9, to seek recognition of exemption under § 501(c)(3) by submitting a Form 1023.

.02 *Application.* An eligible organization seeking recognition of exempt status under § 501(c)(3) using this revenue procedure must submit a completed Form 1023–EZ. See section 4.05 for a definition of completed Form 1023–EZ. An incomplete Form 1023–EZ will not be accepted for processing by the Service even if it has been successfully submitted through *www.pay.gov*. See section 5.02(1).

.03 *User fee.* An application submitted under this revenue procedure must include the correct user fee, which is \$400. In future years, the user fee shall be set forth in a successor revenue procedure to Rev. Proc. 2014–8.

.04 *Method of submission.* An eligible organization seeking recognition of tax exempt status under § 501(c)(3) using this revenue procedure must submit the Form 1023–EZ and user fee online at *www.pay.gov*. Paper submissions will not be accepted and will be treated as incomplete Forms 1023–EZ as described in section 5.02(1).

.05 *Requirements for a completed Form 1023–EZ.* For purposes of this revenue procedure, a Form 1023–EZ submitted by an eligible organization is completed if it:

- (1) includes responses for each required line item of the form, including an accurate date of organization and an attestation that the organization has completed the Form 1023–EZ eligibility worksheet, as in effect on the date of submission, is eligible to apply for exemption using Form 1023–EZ, and has read the *Instructions for Form 1023–EZ* and understands the requirements to be exempt under § 501(c)(3) as expressed therein;
- (2) includes the organization’s correct Employer Identification Number (EIN);
- (3) is electronically signed, under penalties of perjury, by an individual authorized to sign for the organization (as specified in the *Instructions for Form 1023–EZ*); and
- (4) is accompanied by the correct user fee specified in Section 4.03.

A Form 1023–EZ will not be considered completed if the organization’s name and EIN do not match the records in the Service’s Business Master File. Furthermore, a Form 1023–EZ submitted by an organization that is not an eligible organization will not be considered completed.

*.06 Form 1023–EZ from an organization with a pending Form 1023.*

- (1) The Service will accept for processing a completed Form 1023–EZ from an eligible organization that has a Form 1023 pending with the Service, provided that the Form 1023 has not yet been assigned for review. The Form 1023–EZ will be treated as a written request for withdrawal of the pending Form 1023, and the Form 1023 will be treated as withdrawn as described in section 6 of Rev. Proc. 2014–9. The user fee paid for the Form 1023 will generally not be refunded. See section 6 of Rev. Proc. 2014–9. In addition, the filing date of the Form 1023–EZ (not the withdrawn Form 1023) will be treated as the date that the organization provided the notice required under § 508 to the Service. If the filing date of the Form 1023–EZ is within 27 months from the end of the month in which it was organized, the organization may be recognized as exempt from the date it was organized. If it is not, then the organization’s exemption, if granted, will generally be effective from the date the Form 1023–EZ was filed. See section 8 below.
- (2) The Service will not accept for processing a completed Form 1023–EZ from an eligible organization that has a Form 1023 pending with the Service if the Form 1023 has already been assigned for review. If this section 4.06(2) applies, an organization will be notified of the non-acceptance of the Form 1023–EZ and any user fee that was paid with the Form 1023–EZ will be refunded, as described in section 5.02(3).

*.07 No expedited handling.* An organization may not request expedited handling of a Form 1023–EZ submitted under this revenue procedure.

**SECTION 5. STANDARDS  
FOR ISSUING A  
DETERMINATION  
LETTER ON EXEMPT  
STATUS UNDER § 501(c)(3)**

*.01 In general.* This section sets forth procedures that the Service will use to process a Form 1023–EZ.

*.02 Non-acceptance for processing of Forms 1023–EZ.*

- (1) A submitted Form 1023–EZ that is not completed within the meaning of section 4.05 will not be accepted for processing by the Service. The Service may, but is not required to, request additional information under section 5.03 to verify that a Form 1023–EZ is completed. If an organization’s Form 1023–EZ is not accepted for processing, it will be notified of the non-acceptance of its application and any user fee that was paid will be refunded. An eligible organization may then submit a properly completed Form 1023–EZ with a new user fee online at *www.pay.gov*. Alternatively, an eligible organization may apply on a Form 1023 under the procedures described in Rev. Proc. 2014–9.
- (2) The Service will not accept for processing a Form 1023–EZ from an organization if the organization has an application for recognition of tax-exempt status other than a Form 1023 (e.g., Form 1024, *Application for Recognition of Exemption under Section 501(a)*) pending with the Service. An organization will be notified of the non-acceptance of the Form 1023–EZ, and any user fee that was paid with the Form 1023–EZ will be refunded.
- (3) The Service will not accept for processing a Form 1023–EZ from an eligible organization if the organization has a Form 1023 pending with the Service that has been assigned for review. See section 4.06. An organization will be notified of the non-acceptance of the Form 1023–EZ, and any user fee that was paid with the Form 1023–EZ will be refunded.

*.03 Additional information may be required.* The Service may request additional information from any organization before accepting a Form 1023–EZ for processing or making a determination of exempt status. Additionally, the Service will select a statistically valid random sample of Forms 1023–EZ for pre-determination reviews, which may also result in requests for additional information. If the Service requests information prior to accepting a Form 1023–EZ for processing and the organization fails to respond to a request for additional information, the application will not be accepted for processing. In the case of a Form 1023–EZ that has been accepted for processing by the Service, a failure to respond to a request for additional information will result in the closure of the application without a determination letter being issued and without a refund of the user fee.

*.04 Issuance of determination letter.* A favorable determination letter will be issued to an organization only if the attestations contained in the organization's completed and accepted Form 1023-EZ (along with any additional information requested by the Service and provided by the organization) are consistent with requirements for exemption under section 501(c)(3). Exempt status may be recognized in advance of the organization's operations. The determination letter will also classify the organization as either a "public charity" or a "private foundation," consistent with the attestations made and any additional information provided by the organization upon request by the Service.

*.05 Adverse determination letters and appeal procedure.* If the Service concludes, including based on additional information provided under section 5.03, that the organization does not satisfy the requirements for exemption under § 501(c)(3), the Service generally will issue a proposed adverse determination letter, which will:

- (1) include the Service's rationale for the proposed denial of tax-exempt status; and
- (2) advise the organization of its opportunity to appeal the decision and request a conference.

An organization receiving a proposed adverse determination letter will be subject to the procedures described in section 7 of Rev. Proc. 2014-9. Upon issuance of a final adverse determination letter, an organization's proposed adverse and final adverse determination letters are subject to disclosure to the public and state officials as described below in sections 7.02 and 7.03. An adverse determination letter issued under this section 5.05 is a final determination to which § 7428 applies. See section 6. Note, however, that the non-acceptance of a Form 1023-EZ under section 5.02 is not a proposed or final adverse determination.

*.06 Requests for technical advice.* EO Determinations is responsible for the issuance of determination letters to eligible organizations seeking recognition of exempt status under § 501(c)(3) pursuant to this revenue procedure. See Rev. Proc. 2014-4. However, technical advice on a Form 1023-EZ submitted and accepted for processing pursuant to this revenue procedure may be requested by EO Determinations or by an organization pursuant to the procedures described in section 5 of Rev. Proc. 2014-9 and sections 4.04 and 4.05 of Rev. Proc. 2014-5.

*.07 Withdrawal of a Form 1023-EZ.* A Form 1023-EZ may only be withdrawn upon the written request of an authorized individual prior to the issuance of a determination letter (including a proposed adverse determination letter).

- (1) When a Form 1023-EZ is withdrawn, the Service will retain the application. The Service may consider the information submitted in connection with the withdrawn request in a subsequent examination of the organization.
- (2) Generally, the user fee will not be refunded if an application is withdrawn. See Rev. Proc. 2014-8, section 10.

**SECTION 6.  
DECLARATORY  
JUDGMENT PROVISIONS  
OF § 7428**

*.01 General description.* Generally, a declaratory judgment proceeding under § 7428 can be filed in the United States Tax Court, the United States Court of Federal Claims, or the district court of the United States for the District of Columbia with respect to an actual controversy involving a determination by the Service or a failure of the Service to make a determination with respect to the initial or continuing qualification or classification of an organization under § 501(c)(3) (charitable, educational, etc.); § 170(c)(2) (deductibility of contributions); § 509(a) (private foundation status); § 4942(j)(3) (operating foundation status); or § 521 (farmers' cooperative).

*.02 Exhaustion of administrative remedies.* Before filing a declaratory judgment action, an organization must exhaust its administrative remedies by taking, in a timely manner, all reasonable steps to secure a determination from the Service. For purposes of this revenue procedure, these reasonable steps include:

- (1) the filing by an organization of a completed Form 1023-EZ (within the meaning of section 4.05);
- (2) in appropriate cases (i.e., where the organization did not submit Form 1023-EZ within 27 months after the end of the month in which it was organized and seeks an effective date earlier than its submission date), requesting relief pursuant to Treas. Reg. § 301.9100-1 of the Procedure and

- Administration Regulations regarding the extension of time for making an election or application for relief from tax;
- (3) the timely submission of all additional information requested by the Service in accordance with section 5.03; and
  - (4) the exhaustion of all administrative appeals available within the Service pursuant to section 7 of Rev. Proc. 2014–9.

*.03 Service must have reasonable time to act on an appeal.* The steps described in section 6.02 will not be considered completed until the Service has had a reasonable time to act upon an appeal.

*.04 Exhaustion of administrative remedies no earlier than 270 days after seeking determination and taking all reasonable steps to secure a determination letter.* An eligible organization that has submitted Form 1023–EZ will in no event be deemed to have exhausted its administrative remedies prior to the earlier of:

- (1) the completion of the steps in section 6.02 and the sending by the Service by certified or registered mail of a final determination letter; or
- (2) the expiration of the 270-day period described in § 7428(b)(2) in a case in which the Service has not issued a final determination letter, and the eligible organization has taken, in a timely manner, all reasonable steps to secure a determination letter.

*.05 Final determination to which § 7428 applies.* Section 7428 only applies to final determinations. The final determinations to which § 7428 applies are described in section 10.05 of Rev. Proc. 2014–9. The non-acceptance of a Form 1023–EZ under section 5.02 is not a final determination to which § 7428 applies. In addition, an organization will not be considered to have exhausted its administrative remedies by completing the steps in section 6.02 if the organization was not eligible to submit Form 1023–EZ, as described in section 2.01.

*.06 Treatment of withdrawals and non-accepted applications.* The Service does not consider the withdrawal of an application pursuant to section 5.07 or the non-acceptance of an application pursuant to section 5.02 as a failure to make a determination within the meaning of § 7428(a)(2), or an exhaustion of administrative remedies within the meaning of § 7428(b)(2). The 270-day period referred to in § 7428(b)(2) will not be considered to have started prior to the date a completed Form 1023–EZ is submitted to the Service. If the Service requests additional information from an organization pursuant to section 5.03, the period of time beginning on the date the Service requests additional information until the date the information is submitted to the Service will not be counted for purposes of the 270-day period referred to in § 7428(b)(2).

## **SECTION 7. DISCLOSURE OF APPLICATIONS AND DETERMINATION LETTERS**

Sections 6104 and 6110 provide rules for the disclosure of applications, including any additional information received by the Service from the organization pursuant to section 5.03, and determination letters.

*.01 Disclosure of favorable determinations.* The favorable determination letters issued by the Service and the associated Forms 1023–EZ (including any additional information received by the Service from the organization) are available for public inspection under § 6104(a)(1). However, there are certain limited disclosure exceptions for a trade secret, patent, process, style of work, or apparatus, if the Service determines that the disclosure of the information would adversely affect the organization.

- (1) The Service is required to make favorable determination letters and the associated applications available upon request. The public can request this information by submitting Form 4506–A, *Request for Public Inspection or Copy of Exempt or Political Organization IRS Form*. Organizations applying for exemption should ensure that their applications do not include unnecessary personal identifying information (such as bank account numbers or social security numbers) that could result in identity theft or other adverse consequences if publicly disclosed.
- (2) The exempt organization is required to make its exemption application and determination letter available for public inspection without charge. For more information about the exempt organization's disclosure obligations, see Publication 557, *Tax-Exempt Status for Your Organization*.

*.02 Disclosure of adverse determinations.* The Service is required to make adverse determination letters available for public inspection under § 6110 after the deletion of names, addresses, and other identifying information. Upon issuance of a final adverse determination letter to an eligible organization pursuant to section 5.05, both the proposed adverse determination letter and the final adverse determination letter will be available for public inspection in accordance with section 8.02 of Rev. Proc. 2014–9.

*.03 Disclosure to state officials.*

- (1) The Service may disclose to State officials the name, address, and EIN of any organization that has applied for recognition of exemption under § 501(c)(3), including an organization that applies using Form 1023–EZ under this revenue procedure.
- (2) The Service may notify the appropriate State officials of a refusal to recognize an organization as tax-exempt under § 501(c)(3). See § 6104(c). The Service does not consider the non-acceptance of an application under section 5.02 to be a refusal. See section 8.03 of Rev. Proc. 2014–9, for more information about disclosure in cases where the Service refuses to recognize an organization as exempt under § 501(c)(3).

## **SECTION 8. EFFECT OF DETERMINATION LETTER RECOGNIZING EXEMPTION**

*.01 Effective date of exemption.* A determination letter recognizing exemption of an organization described in § 501(c)(3) is usually effective as of the date of formation of an organization if: (1) its purposes and activities prior to the date of the determination letter have been consistent with the requirements for exemption; (2) it has not failed to file required Form 990 series returns or notices for three consecutive years; and (3) it has submitted an application for recognition of exemption within 27 months from the end of the month in which it was organized. Special rules may apply to certain organizations applying for exemption under § 501(c)(3). See § 508, and Treas. Reg. §§ 1.508–1(a)(2), 1.508–1(b)(7), and 301.9100–2(a)(2)(iv).

- (1) If the Service requires the organization to alter its activities or make substantive amendments to its enabling instrument, the exemption will be effective as of the date specified in the determination letter.
- (2) If an eligible organization has submitted a Form 1023–EZ within 27 months from the end of the month in which it was organized and the Service requires the organization to make a nonsubstantive amendment, exemption will ordinarily be recognized as of the date of formation. Examples of nonsubstantive amendments include correction of a clerical error in the enabling instrument or the addition of a dissolution clause where the activities of the organization prior to the determination letter are consistent with the requirements for exemption.
- (3) An eligible organization applying under this revenue procedure that does not submit Form 1023–EZ within 27 months from the end of the month in which it was organized will generally be recognized as exempt from the submission date of its Form 1023–EZ. For this purpose, the submission date of Form 1023–EZ is determined without regard to the submission date of any previously submitted application for recognition of tax-exemption (including a Form 1023–EZ, Form 1023, or Form 1024) that has been withdrawn by the organization or not accepted for processing by the Service. Thus, if an eligible organization that has a Form 1023 pending with the Service files a Form 1023–EZ in accordance with section 4.06 outside the 27-month window, it will generally be recognized as exempt from the submission date of its Form 1023–EZ, not from the date it submitted its Form 1023. An organization that believes it qualifies for an earlier effective date may request the earlier date by sending correspondence to the address listed in the *Instructions for Form 1023–EZ*. The correspondence should include the organization’s name, EIN, the effective date the organization is requesting, an explanation of why the earlier date is warranted, and any supporting documents. This correspondence should be sent after the organization receives its determination letter. Alternatively, the organization may complete Form 1023 instead of completing Form 1023–EZ.

*.02 Reliance on determination letter.* A determination letter recognizing exemption may not be relied upon if there is a material change, inconsistent with exemption, in the character, the purpose, or the method of operation of the organization, or a change in the applicable law. Also, a determination letter issued to an organization that submitted a Form 1023–EZ in accordance with this revenue procedure may not be relied upon if it was based on any inaccurate material information submitted by the

organization. Inaccurate material information includes an incorrect attestation as to the organization's organizational documents, the organization's exempt purposes, the organization's conduct of prohibited and restricted activities, or the organization's eligibility to file Form 1023-EZ. See also section 9.

.03 *Automatic revocation.* Organizations that claim exempt status under § 501(c) generally must file annual Form 990 series returns or notices, even if they have not yet received their determination letter recognizing exemption. If an organization fails to file required Form 990 series returns or notices for three consecutive years, its exemption will be automatically revoked by operation of § 6033(j). Such an organization may apply for reinstatement of its exempt status, and such recognition may be granted retroactively, as provided in Rev. Proc. 2014-11. Consistent with the eligibility requirements for using Form 1023-EZ that are set forth in section 2.01, only an organization requesting reinstatement of § 501(c)(3) status under section 4 (streamlined retroactive reinstatement of tax-exempt status for small organizations within 15 months of revocation) or section 7 (reinstatement of tax-exempt status from postmark date) of Rev. Proc. 2014-11 may apply using Form 1023-EZ. An organization requesting reinstatement of § 501(c)(3) status under section 5 (retroactive reinstatement of tax-exempt status within 15 months of revocation) or section 6 (retroactive reinstatement more than 15 months after revocation) of Rev. Proc. 2014-11 must apply using Form 1023 under Rev. Proc. 2014-9.

.04 *Filing requirement.* Generally, an organization that qualifies for exemption under § 501(c)(3) is required to file an annual return in accordance with § 6033(a). However, an eligible organization, other than a private foundation, that normally has gross receipts of \$50,000 or less is not required to file an annual return, but must furnish notice on Form 990-N providing the information required by § 6033(i). See Rev. Proc. 2011-15, 2011-3 I.R.B. 322. An eligible organization (other than a private foundation) that applies for recognition of exempt status under this revenue procedure is not required to separately notify the Service that it is excepted from the annual filing requirement under § 6033(a) if it is claiming a filing exemption solely on the basis that its gross receipts are normally \$50,000 or less. However, if such an organization claims an exception from filing an annual return under § 6033(a) on a basis other than it being an organization (other than a private foundation) that normally has gross receipts of \$50,000 or less, it must file a Form 8940, *Request for Miscellaneous Determination*, with the Service and provide a statement of all of the facts on which its claim is based. A separate user fee will be required when filing the Form 8940.

**SECTION 9.  
REVOCATION OR  
MODIFICATION OF  
DETERMINATION  
LETTER RECOGNIZING  
EXEMPTION**

.01 *In general.* A determination letter recognizing exemption may be revoked or modified: (1) by a notice to the taxpayer to whom the determination letter was issued; (2) by enactment of legislation or ratification of a tax treaty; (3) by a decision of the Supreme Court of the United States; (4) by the issuance of temporary or final regulations; (5) by the issuance of a revenue ruling, revenue procedure, or other statement published in the Internal Revenue Bulletin; or (6) automatically, pursuant to § 6033(j), for failure to file a required annual return or notice for three consecutive years.

.02 *Retroactive revocation or modification.* The revocation or modification of a determination letter recognizing the exemption of an organization that submitted a Form 1023-EZ in accordance with this revenue procedure may be retroactive if there has been a change in the applicable law, if the organization operated in a manner materially different from that represented on its completed Form 1023-EZ (including any additional information provided), or if the organization misstated or omitted any material information on its completed Form 1023-EZ (including any additional information provided). A misstatement of material information includes an incorrect attestation as to the organization's organizational documents, the organization's exempt purposes, the organization's conduct of prohibited and restricted activities, or the organization's eligibility to file Form 1023-EZ. Information provided on an application for recognition of exemption (e.g., Form 1023-EZ, Form 1023, or Form 1024) that has been withdrawn will not be considered for purposes of limiting the retroactive effect of a revocation or modification of a determination letter. In certain cases an organization may seek relief from retroactive revocation or modification of a determination letter under § 7805(b). Requests for § 7805(b) relief may be made as described in section 12 of Rev. Proc. 2014-9 and Rev. Proc. 2014-4.

.03 *Appeal and conference procedures.* In the case of a revocation or modification of a determination letter, the appeal and conference procedures are the same as those set out in section 12 of Rev. Proc. 2014-9.

**SECTION 10. EFFECTIVE DATE**

This revenue procedure is effective July 1, 2014.

**SECTION 11. DRAFTING INFORMATION**

The principal authors of this Revenue Procedure are Timothy Berger and Melinda Williams of the Exempt Organizations, Tax Exempt and Government Entities Division, and James Martin of the Office of Associate Chief Counsel (Tax Exempt and Government Entities). For additional information, please contact Mr. Berger at 202-317-8533, Ms. Williams at 202-317-8532, or Mr. Martin at 202-317-5800 (these are not toll-free numbers).

**SECTION 12. PAPERWORK REDUCTION ACT**

Any collection of information under this revenue procedure will be reported and approved through Form 1023-EZ (OMB approval number 1545-0056).

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

**SECTION 13. REQUEST FOR COMMENTS**

The Service and the Treasury Department request comments on this revenue procedure, which will be considered in making any future update to these procedures.

Comments should refer to Rev. Proc. 2014-40, and should be submitted to:

Internal Revenue Service  
Attn: CC:PA:LPD:PR  
(Rev. Proc. 2014-40) Room 5203  
P. O. Box 7604  
Ben Franklin Station  
Washington, DC 20044

Submissions also may be hand delivered Monday through Friday between the hours of 8 am and 4 pm to CC:PA:LPD:PR (Rev. Proc. 2014-40) Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, N.W. Washington, D.C. Alternatively, comments may be submitted electronically via the following e-mail address: *Notice.Comments@irs.counsel.treas.gov*. Please include "Rev. Proc. 2014-40" in the subject line of any electronic communication. All comments will be available for public inspection and copying.

## Part IV. Items of General Interest

### Notice of proposed rulemaking by cross-reference to temporary regulations

### Guidelines for the Streamlined Process of Applying for Recognition of Section 501(c)(3) Status

#### REG-110948-14

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking by cross-reference to temporary regulations.

SUMMARY: In the Rules and Regulations section of this issue of the *Bulletin*, the IRS is issuing regulations that provide guidance to organizations that seek recognition of tax-exempt status under section 501(c)(3) of the Internal Revenue Code. The final and temporary regulations amend current regulations to allow the Commissioner of Internal Revenue to adopt a streamlined application process that certain organizations may use to apply for recognition of tax-exempt status under section 501(c)(3). The text of those temporary regulations also serves as the text of these proposed regulations.

DATES: Comments and requests for a public hearing must be received by September 30, 2014.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-110948-14), room 5205, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG-110948-14), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW, Washington, DC, or sent electronically via the Federal eRulemaking Portal at <http://www.regulations.gov> (IRS REG-110948-14).

#### FOR FURTHER INFORMATION

CONTACT: Concerning the proposed regulations, James R. Martin or Robin Eh-

renberg at (202) 317-5800; concerning submission of comments and request for hearing, Oluwafunmilayo Taylor at (202) 317-6901 (not toll-free numbers).

#### SUPPLEMENTARY INFORMATION:

##### Background and Explanation of Provisions

Temporary regulations in the Rules and Regulations section of this issue of the *Bulletin* amend the existing regulations under sections 501 and 508 to allow for an additional form of application to be used to satisfy the notice requirement under section 508(a). The text of those temporary regulations also serves as the text of these proposed regulations. The preamble to the temporary regulations explains the amendments.

##### Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866, as supplemented by Executive Order 13563. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. It is hereby certified that this rule will not have a significant economic impact on a substantial number of small entities. Although this rule may affect a substantial number of small entities that choose to use the new form that streamlines the application process that eligible organizations may use to apply for recognition of tax-exempt status under section 501(c)(3), we intend for this rule to reduce the economic impact on small entities. This rule merely provides guidance about the streamlined form of application available to satisfy the notice requirement under Section 508(a). Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. Chapter 6) is not required.

##### Comments and Requests for Public Hearing

Before these proposed regulations are adopted as final regulations, consideration

will be given to any comments that are submitted timely to the IRS as prescribed in this preamble under the "Addresses" heading. The Treasury Department and the IRS request comments on all aspects of the proposed rules. All comments will be available at [www.regulations.gov](http://www.regulations.gov) or upon request.

A public hearing will be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the *Federal Register*.

##### Drafting Information

The principal authors of these regulations are James R. Martin and Robin Ehrenberg, Office of Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and the Treasury Department participated in their development.

\* \* \* \* \*

##### Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

#### PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows: Authority: 26 U.S.C. 7805 \* \* \*

Par. 2. Section 1.501(a)-1 is amended by:

1. Revising paragraph (a)(2).
2. Revising paragraph (b)(1) and (b)(3).
3. Adding paragraph (f).

The revisions and addition read as follows:

##### § 1.501(a)-1 Exemption from taxation.

(a) \* \* \*

(2) [The text of the proposed amendment to § 1.501(a)-1(a)(2) is the same as the text for § 1.501(a)-1T(a)(2) published elsewhere in this issue of the *Bulletin*.]

\* \* \* \* \*

(b)(1) [The text of the proposed amendment to § 1.501(a)–1(b)(1) is the same as the text for § 1.501(a)–1T(b)(1) published elsewhere in this issue of the **Bulletin**].

\* \* \* \* \*

(3) [The text of the proposed amendment to § 1.501(a)–1(b)(3) is the same as the text for § 1.501(a)–1T(b)(3) published elsewhere in this issue of the **Bulletin**].

\* \* \* \* \*

(f) [The text of the proposed amendment to § 1.501(a)–1(f) is the same as the text for § 1.501(a)–1T(f) published elsewhere in this issue of the **Bulletin**].

Par. 3. Section 1.501(c)(3)–1 is amended by:

1. Revising paragraphs (b)(1)(v) and (b)(6).
2. Adding paragraph (h).

The revisions and addition read as follows:

*§ 1.501(c)(3)–1 Organizations organized and operated for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals.*

\* \* \* \* \*

(b)\* \* \* (1)\* \* \*

(v) [The text of proposed amendments to § 1.501(c)(3)–1(b)(1)(v) is the same as the text for § 1.501(c)(3)–1T(b)(1)(v) published elsewhere in this issue of the **Bulletin**].

\* \* \* \* \*

(6) [The text of proposed amendments to § 1.501(c)(3)–1(b)(6) is the same as the text for § 1.501(c)(3)–1T(b)(6) published elsewhere in this issue of the **Bulletin**].

\* \* \* \* \*

(h) [The text of proposed amendments to § 1.501(c)(3)–1(h) is the same as the text for § 1.501(c)(3)–1T(h) published elsewhere in this issue of the **Bulletin**].

Par. 4. Section 1.508–1 is amended by:

1. Revising paragraphs (a)(2)(i) and (a)(2)(ii).
2. Revising paragraphs (b)(2)(iv) and (b)(2)(v).
3. Adding paragraph (c).

The revisions and addition read as follows:

*§ 1.508–1 Notices.*

(a) \* \* \*

(2)(i) [The text of proposed amendments to § 1.508–1(a)(2)(i) is the same as the text for § 1.508–1T(a)(2)(i) published elsewhere in this issue of the **Bulletin**].

(ii) [The text of proposed amendments to § 1.508–1(a)(2)(ii) is the same as the text for § 1.508–1T(a)(2)(ii) published elsewhere in this issue of the **Bulletin**].

\* \* \* \* \*

(b) \* \* \*

(2) \* \* \*

(iv) [The text of proposed amendments to § 1.508–1(b)(2)(iv) is the same as the text for § 1.508–1T(b)(2)(iv) published elsewhere in this issue of the **Bulletin**].

(v) [The text of proposed amendments to § 1.508–1(b)(2)(v) is the same as the text for § 1.508–1T(b)(2)(v) published elsewhere in this issue of the **Bulletin**].

\* \* \* \* \*

(c) [The text of proposed amendments to § 1.508–1(c) is the same as the text for § 1.508–1T(c) published elsewhere in this issue of the **Bulletin**].

John Dalrymple,  
*Deputy Commissioner for  
Services and Enforcement.*

(Filed by the Office of the Federal Register on July 1, 2014, 8:45 a.m., and published in the issue of the Federal Register for July 2, 2014, 79 F.R. 37697)

# Definition of Terms

*Revenue rulings and revenue procedures (hereinafter referred to as “rulings”) that have an effect on previous rulings use the following defined terms to describe the effect:*

*Amplified* describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with modified, below).

*Clarified* is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

*Distinguished* describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

*Modified* is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A

and B, the prior ruling is modified because it corrects a published position. (Compare with amplified and *clarified*, above).

*Obsoleted* describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in laws or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

*Revoked* describes situations where the position in the previously published ruling is not correct and the correct position is being stated in a new ruling.

*Superseded* describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new

ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, modified and *superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case, the previously published ruling is first modified and then, as modified, is superseded.

*Supplemented* is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

*Suspended* is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

# Abbreviations

*The following abbreviations in current use and formerly used will appear in material published in the Bulletin.*

A—Individual.  
Acq.—Acquiescence.  
B—Individual.  
BE—Beneficiary.  
BK—Bank.  
B.T.A.—Board of Tax Appeals.  
C—Individual.  
C.B.—Cumulative Bulletin.  
CFR—Code of Federal Regulations.  
CI—City.  
COOP—Cooperative.  
Ct.D.—Court Decision.  
CY—County.  
D—Decedent.  
DC—Dummy Corporation.  
DE—Donee.  
Del. Order—Delegation Order.  
DISC—Domestic International Sales Corporation.  
DR—Donor.  
E—Estate.  
EE—Employee.  
E.O.—Executive Order.  
ER—Employer.

ERISA—Employee Retirement Income Security Act.  
EX—Executor.  
F—Fiduciary.  
FC—Foreign Country.  
FICA—Federal Insurance Contributions Act.  
FISC—Foreign International Sales Company.  
FPH—Foreign Personal Holding Company.  
F.R.—Federal Register.  
FUTA—Federal Unemployment Tax Act.  
FX—Foreign corporation.  
G.C.M.—Chief Counsel’s Memorandum.  
GE—Grantee.  
GP—General Partner.  
GR—Grantor.  
IC—Insurance Company.  
I.R.B.—Internal Revenue Bulletin.  
LE—Lessee.  
LP—Limited Partner.  
LR—Lessor.  
M—Minor.  
Nonacq.—Nonacquiescence.  
O—Organization.  
P—Parent Corporation.  
PHC—Personal Holding Company.  
PO—Possession of the U.S.  
PR—Partner.  
PRS—Partnership.

PTE—Prohibited Transaction Exemption.  
Pub. L.—Public Law.  
REIT—Real Estate Investment Trust.  
Rev. Proc.—Revenue Procedure.  
Rev. Rul.—Revenue Ruling.  
S—Subsidiary.  
S.P.R.—Statement of Procedural Rules.  
Stat.—Statutes at Large.  
T—Target Corporation.  
T.C.—Tax Court.  
T.D.—Treasury Decision.  
TFE—Transferee.  
TFR—Transferor.  
T.I.R.—Technical Information Release.  
TP—Taxpayer.  
TR—Trust.  
TT—Trustee.  
U.S.C.—United States Code.  
X—Corporation.  
Y—Corporation.  
Z—Corporation.

## **Numerical Finding List<sup>1</sup>**

Bulletins 2014–27 through 2014–30

### **Announcements:**

2014-2, 2014-28 I.R.B. 120

### **Notices:**

2014-40, 2014-27 I.R.B. 100

2014-41, 2014-27 I.R.B. 97

### **Proposed Regulations:**

REG-110948-14, 2014-30 I.R.B. 239

REG-121542-14, 2014-28 I.R.B. 119

### **Revenue Procedures:**

2014-26, 2014-27 I.R.B. 26

2014-27, 2014-27 I.R.B. 41

2014-29, 2014-28 I.R.B. 105

2014-38, 2014-29 I.R.B. 132

2014-39, 2014-29 I.R.B. 151

2014-40, 2014-30 I.R.B. 229

2014-42, 2014-29 I.R.B. 193

### **Revenue Rulings:**

2014-14, 2014-27 I.R.B. 12

2014-20, 2014-28 I.R.B. 101

### **Treasury Decisions:**

9668, 2014-27 I.R.B. 1

9669, 2014-28 I.R.B. 103

9670, 2014-29 I.R.B. 121

9671, 2014-29 I.R.B. 124

9672, 2014-30 I.R.B. 196

9673, 2014-30 I.R.B. 212

9674, 2014-30 I.R.B. 225

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<sup>1</sup>A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2014–01 through 2014–26 is in Internal Revenue Bulletin 2014–26, dated June 30, 2014.

## **Finding List of Current Actions on Previously Published Items<sup>1</sup>**

Bulletins 2014–27 through 2014–30

### **Announcements:**

#### **2012-11**

Supplemented by  
Ann. 2014-2, 2014-28 I.R.B. 120

#### **2013-11**

Supplemented by  
Ann. 2014-2, 2014-28 I.R.B. 120

### **Revenue Procedures:**

#### **1981-38**

Superseded by  
Rev. Proc. 2014-42, 2014-29 I.R.B. 193

#### **1981-38**

Modified by  
Rev. Proc. 2014-42, 2014-29 I.R.B. 193

#### **2000-12**

Superseded by  
Rev. Proc. 2014-39, 2014-29 I.R.B. 151

#### **2002-55**

Revoked by  
Rev. Proc. 2014-39, 2014-29 I.R.B. 151

#### **2012-38**

Superseded by  
Rev. Proc. 2014-27, 2014-27 I.R.B. 26

#### **2012-46**

Superseded by  
Rev. Proc. 2014-26, 2014-27 I.R.B. 41

#### **2014-4**

Amplified by  
Rev. Proc. 2014-40, 2014-30 I.R.B. 229

#### **2014-5**

Amplified by  
Rev. Proc. 2014-40, 2014-30 I.R.B. 229

#### **2014-8**

Supplemented by  
Rev. Proc. 2014-40, 2014-30 I.R.B. 229

#### **2014-9**

Amplified by  
Rev. Proc. 2014-40, 2014-30 I.R.B. 229

#### **2014-10**

Amplified by  
Rev. Proc. 2014-40, 2014-30 I.R.B. 229

## **Revenue Procedures—Continued:**

#### **2014-11**

Amplified by  
Rev. Proc. 2014-40, 2014-30 I.R.B. 229

#### **2014-13**

Modified by  
Rev. Proc. 2014-38, 2014-29 I.R.B. 132

#### **2014-13**

Superseded by  
Rev. Proc. 2014-38, 2014-29 I.R.B. 132

### **Treasury Decision:**

#### **2005-47**

Obsoleted by  
T.D. 9668 2014-27 I.R.B. 1

<sup>1</sup>A cumulative list of current actions on previously published items in Internal Revenue Bulletins 2014–01 through 2014–26 is in Internal Revenue Bulletin 2014–26, dated June 30, 2014.

# INDEX

## Internal Revenue Bulletins 2014–27 through 2014–30

The abbreviation and number in parenthesis following the index entry refer to the specific item; numbers in roman and italic type following the parentheses refer to the Internal Revenue Bulletin in which the item may be found and the page number on which it appears.

### Key to Abbreviations:

Ann	Announcement
CD	Court Decision
DO	Delegation Order
EO	Executive Order
PL	Public Law
PTE	Prohibited Transaction Exemption
RP	Revenue Procedure
RR	Revenue Ruling
SPR	Statement of Procedural Rules
TC	Tax Convention
TD	Treasury Decision
TDO	Treasury Department Order

## ADMINISTRATIVE

Annual Filing Season Program (RP 42) 29, 193

Regulations Governing Practice Before the Internal Revenue Service (REG–138367–06) (TD 9668) 27, 1

### Regulations:

31 CFR 10.1, revised; 10.3, revised; 10.22, revised; 10.31, revised; 10.35, revised; 10.36, revised; 10.37, revised; 10.52, revised; 10.81, revised; 10.82, revised; 10.91, revised. (TD 9668) 27, 1

Announcement to Discontinue the Internal Revenue Bulletin Index (Ann 27) 28, 120

Substitute Forms Preparation for Certain Information Returns (RP 27) 27, 41

## EMPLOYEE PLANS

Longevity Annuity Contracts (TD 9673) 30, 212

### Regulations:

26 CFR 54.9815–2708, as amended (TD 9671) 29, 124

26 CFR 1.401(a)(9)–5, amended; 1.401(a)(9)–6, amended; 1.403(b)–6, amended; 1.408–8, amended; 1.408A–6, amended; 1.6047–2, added (TD 9673) 30, 212

Rules relating to 90 day waiting period limitation (TD 9671) 29, 124

Weighted average interest rates

Segment rates for June 2014 (Notice 41) 27, 97

## EMPLOYMENT TAX

Extending religious and family member FICA and FUTA exceptions to disregarded entities; regulations regarding the indoor tanning services excise tax and disregarded entities (TD 9670) 29, 121

## EMPLOYMENT TAX—Cont.

### Publications:

1223, General Rules and Specifications for Substitute Forms W–2c and W–3c (RP29) 28, 105

4436, General Rules and Specifications for Substitute Form 941 and Schedule B (Form 941), and Schedule R (RP 26) 27, 26

Summons Interview Regulations Under Section 7602 (REG–121542–14) (TD 9669) 28, 103

### Regulations:

26 CFR 301.7602–1 is amended to add new paragraph (b)(3) pertaining to summons interviews. (TD 9669) 28, 103

26 CFR 1.1361–4, amended; 1.1361–4T, removed; 31.3121(b)(3)–1, amended; 31.3121(b)(3)–1T, removed; 31.3127–1, added; 31.3127–1T, removed; 31.3306(c)(5)–1, amended; 31.3306(c)(5)–1T, removed; 301.7701–2, amended; 301.7701–2T, removed; extending religious and family member FICA and FUTA exceptions to disregarded entities; regulations regarding the indoor tanning services excise tax and disregarded entities (TD 9670) 29, 121

## ESTATE TAX

Summons Interview Regulations Under Section 7602 (REG–121542–14) (TD 9669) 28, 103

### Regulations:

26 CFR 301.7602–1 is amended to add new paragraph (b)(3) pertaining to summons interviews. (TD 9669) 28, 103

## EXCISE TAX

Extending religious and family member FICA and FUTA exceptions to disregarded entities; regulations regarding the indoor tanning services excise tax and disregarded entities (TD 9670) 29, 121

Summons Interview Regulations Under Section 7602 (REG–121542–14) (TD 9669) 28, 103

### Regulations:

26 CFR 301.7602–1 is amended to add new paragraph (b)(3) pertaining to summons interviews. (TD 9669) 28, 103

26 CFR 1.1361–4, amended; 1.1361–4T, removed; 31.3121(b)(3)–1, amended; 31.3121(b)(3)–1T, removed; 31.3127–1, added; 31.3127–1T, removed; 31.3306(c)(5)–1, amended; 31.3306(c)(5)–1T, removed; 301.7701–2, amended; 301.7701–2T, removed; extending religious and family member FICA and FUTA exceptions to disregarded entities; regulations regarding the indoor tanning services excise tax and disregarded entities (TD 9670) 29, 121

26 CFR 54.9815–2708, as amended (TD 9671) 29, 124

Rules relating to 90 day waiting period limitation (TD 9671) 29, 124

## EXEMPT ORGANIZATIONS

Procedures for Streamlined Application for Recognition of Exemption Under Section 501(c)(3) (RP 40) 30, 229

## EXEMPT ORGANIZATIONS—Cont.

Streamlined process for 501(c)(3) recognition (REG-110948-14) 30, 239

Streamlined process for 501(c)(3) recognition (TD 9674) 30, 225

Regulations:

26 CFR 1.501(c)-1 amended 1. 501(a)-1T added; 1.501(c)(3)-1 amended, 1.501(c)(3)-1T added; and 1.508-1 amended, 1.508-1T added (REG-110948-14) (TD 9674) 30, 225

## GIFT TAX

Summons Interview Regulations Under Section 7602 (REG-121542-14) (TD 9669) 28, 103

Regulations:

26 CFR 301.7602-1 is amended to add new paragraph (b)(3) pertaining to summons interviews (REG-121542-14) (TD 9669) 28, 103

## INCOME TAX

Credit for carbon dioxide Sequestration (Notice 40) 27, 100

FFI Agreement for Participating FFI and Reporting Model 2 FFI (RP 38) 29, 132

Interest:

Investment:

Federal short-term, mid-term, and long-term rates for: July 2014 (RR 20) 28, 101

Summons Interview Regulations Under Section 7602 (REG-121542-14) (TD 9669) 28, 103

Publications:

1223, General Rules and Specifications for Substitute Forms W-2c and W-3c (RP 29) 28, 105

4436, General Rules and Specifications for Substitute Form 941 and Schedule B (Form 941), and Schedule R (RP 26) 27, 26

Qualified Intermediary (QI) Agreement (RP 39) 29, 151

Regulations:

31 CFR 10.1, revised; 10.3, revised; 10.22, revised; 10.31, revised; 10.35, revised; 10.36, revised; 10.37, revised; 10.52, revised; 10.81, revised; 10.82, revised; 10.91, revised (TD 9668) 27, 1

26 CFR 301.7602-1 is amended to add new paragraph (b)(3) pertaining to summons interviews (REG-121542-14) (TD 9669) 28, 103

26 CFR 1.45R-0, added; 1.45R-1, added; 1.45R-2, added; 1.45R-3, added; 1.45R-4, added; 1.45R-5, added; tax credit for employee health insurance expenses of small employers (TD 9672) 30, 196

Regulations Governing Practice Before the Internal Revenue Service (REG-138367-06) (TD 9668) 27, 1

Tax Credit for Employee Health Insurance Expenses of Small Employers (TD 9672) 30, 196

Substitute Forms Preparation for Certain Information Returns (RP 27) 27, 41

Underpayment and overpayments, quarter beginning: July 1, 2014 (RR 14) 27, 12

## SELF-EMPLOYMENT TAX

Extending religious and family member FICA and FUTA exceptions to disregarded entities; regulations regarding the indoor tanning services excise tax and disregarded entities (TD 9670) 29, 121

Regulations:

26 CFR 1.1361-4, amended; 1.1361-4T, removed; 31.3121(b)(3)-1, amended; 31.3121(b)(3)-1T, removed; 31.3127-1, added; 31.3127-1T, removed; 31.3306(c)(5)-1, amended; 31.3306(c)(5)-1T, removed; 301.7701-2, amended; 301.7701-2T, removed; extending religious and family member FICA and FUTA exceptions to disregarded entities; regulations regarding the indoor tanning services excise tax and disregarded entities (TD 9670) 29, 121

## SPECIAL ANNOUNCEMENT

Annual Filing Season Program (RP 42) 29, 193

# Internal Revenue Service

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