INTERNAL REVENUE
BULLETIN

HIGHLIGHTS OF THIS ISSUE

Bulletin No. 2020–22
May 26, 2020

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.

ADMINISTRATIVE

Rev. Proc. 2020-21, page 872.

This revenue procedure provides temporary guidance regarding the public approval requirement under § 147(f) of the Internal Revenue Code (Code) for tax-exempt qualified private activity bonds. Specifically, in light of the Coronavirus Disease 2019 (COVID-19) pandemic, this revenue procedure provides that hearings held by teleconference as described in section 4.01 of this revenue procedure will be treated as held in a location that, based on the facts and circumstances, is convenient for residents of the approving governmental unit for the purpose of § 1.147-1(d)(2) of the Income Tax Regulations.

ADMINISTRATIVE, INCOME TAX

Rev. Proc. 2020-30, page 873.

As a result of travel restrictions and disruptions resulting from the global outbreak of the virus that causes COVID-19, individuals may temporarily conduct activities in a foreign country that would not otherwise have been conducted there. This revenue procedure provides that certain of these activities are not taken into account for purposes of section 1503(d) or Form 8858.

EMPLOYEE PLANS, INCOME TAX

Notice 2020-33, page 868.

This notice increases the $500 limit for unused amounts remaining in a health FSA that may be carried over into the following year by making the carryover amount 20 percent of the maximum salary reduction amount under § 125(i), which is indexed for inflation. For 2020, the carryover amount will increase to $550. The notice cross references Notice 2020-29 for guidance on how a § 125 cafeteria plan may be amended to allow prospective health FSA election changes for the 2020 calendar year. Regarding individual coverage HRAs, this notice also provides clarification regarding reimbursement for premium expenses occurring prior to the beginning of the plan year (generally addressing the need to pay the premium for January health insurance coverage in December of the previous year).

INCOME TAX

Notice 2020-25, page 863.

Notice to temporarily expand the circumstances and time periods in which a tax-exempt bond that is purchased by its state or local governmental issuer is treated as continuing in effect without resulting in a reissuance or retirement of the purchased tax-exempt bond for purposes of § 103 and §§ 141 through 150 of the Internal Revenue Code.

Notice 2020-29, page 864.

To assist with the nation's response to the 2019 Novel Coronavirus outbreak (COVID-19), this notice provides for increased flexibility with respect to mid-year elections under a § 125 cafeteria plan during calendar year 2020 related to employer-sponsored health coverage, health Flexible Spending Arrangements (health FSAs), and dependent care assistance programs. This notice also provides increased flexibility with respect to grace periods to apply unused amounts in health FSAs to medical care expenses incurred through December 31, 2020, and unused amounts in dependent care assistance programs to dependent care expenses incurred through December 31, 2020. Further, the notice provides that the relief provided in Notice 2020-15, 2020-14 IRB 559 regarding high deductible health plans and expenses related to COVID-19, and in section 3701 of the Coronavirus Aid, Relief, and Economic Security Act

Finding Lists begin on page ii.

(CARES Act) regarding a temporary exemption for telehealth services, may be applied retroactively to January 1, 2020.

REG-113295-18, page 875.

This document contains proposed regulations clarifying that the following deductions allowed to an estate or non-grantor trust are not miscellaneous itemized deductions subject to suspension under section 67(g): costs paid or incurred in connection with the administration of an estate or non-grantor trust that would not have been incurred if the property were not held in the estate or trust, the personal exemption of an estate or non-grantor trust, the distribution deduction for trusts distributing current income, and the distribution deduction for estates and trusts accumulating income. The proposed regulations also provide guidance on determining the character, amount, and allocation of deductions in excess of gross income succeeded to by a beneficiary on the termination of an estate or non-grantor trust.

Rev. Proc. 2020-19, page 871.

To enable publicly offered real estate investment trusts (REITs) and publicly offered regulated investment companies (RICs) to conserve capital, this revenue procedure modifies the safe harbor provided in Rev. Proc. 2017-45, 2017-35 I.R.B. 216, to temporarily reduce the minimum amount of cash that shareholders may receive to not less than 10 percent of the total declared distribution in order for the distribution to be taxable under section 301 by reason of section 305(b). This revenue procedure modifies Rev. Proc. 2017-45 solely with respect to distributions declared by a publicly offered REIT or publicly offered RIC on or after April 1, 2020, and on or before December 31, 2020.

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 III

Expanded Temporary Rule Allowing Governmental Issuers to Purchase Certain of Their Own Tax-Exempt Bonds

Notice 2020-25

SECTION 1. PURPOSE

This notice temporarily expands the circumstances and time periods in which a tax-exempt bond that is purchased by its state or local governmental issuer is treated as continuing in effect without resulting in a reissuance or retirement of the purchased tax-exempt bond solely for purposes of § 103 and §§ 141 through 150 of the Internal Revenue Code (Code).

SECTION 2. BACKGROUND

Notice 2008-41, 2008-15 I.R.B. 742, and proposed regulations regarding reissuance of state or local bonds (83 F.R. 67701, December 31, 2018) (proposed regulations) provide rules that allow governmental issuers to purchase their own tax-exempt qualified tender bonds on a temporary basis without resulting in a reissuance or retirement of the purchased tax-exempt bonds solely for purposes of § 103 and §§ 141 to 150. Pursuant to the preamble to the proposed regulations, issuers may apply proposed § 1.150-3 to events and actions taken with respect to bonds that occur before the date that is 90 days after the date of publication of the Treasury decision adopting those rules as final regulations in the Federal Register. 83 F.R. at 67703.

In recognition of the need for liquidity and stability in the markets, including the short-term tax-exempt bond market, during the current period of economic disruption, this notice provides expanded time periods during which governmental issuers may purchase and hold their own tax-exempt qualified tender bonds and tax-exempt commercial paper. For purposes of this notice, the term "tax-exempt commercial paper" means tax-exempt bonds issued pursuant to the same commercial paper program that are treated as a single issue under § 1.150-1(c)(4)(ii) of the Income Tax Regulations.

SECTION 3. SCOPE AND APPLICATION

3.1. *Permitted holding period*. For purposes of this notice, the term "permitted holding period" means calendar year 2020.

3.2. *Expanded temporary rule allowing governmental issuers to purchase their own tax-exempt bonds*. Solely for purposes of § 103 and §§ 141 through 150, the Department of the Treasury (Treasury Department) and the Internal Revenue Service (IRS) will treat a tax-exempt qualified tender bond or tax-exempt commercial paper that is purchased by its governmental issuer on a temporary basis as continuing in effect without resulting in a reissuance or retirement of the purchased tax-exempt bond if the governmental issuer purchases the tax-exempt qualified tender bond or tax-exempt commercial paper during the permitted holding period and holds the bond no later than the end of the permitted holding period.

Thus, recognizing that the purchased bond is treated as continuing in effect without resulting in a reissuance or retirement of that bond solely for purposes of § 103 and §§ 141 through 150 during the permitted holding period, the governmental issuer may refund the purchased bond with a refunding bond, tender the purchased bond for purchase in a qualified tender right in its capacity as a bondholder, or otherwise resell the purchased bond during this permitted holding period. Further, in the case of the purchase of any particular obligation of tax-exempt commercial paper, including a purchase of such a particular obligation at maturity, a refinancing of that purchased tax-exempt commercial paper with tax-exempt commercial paper during the permitted holding period will be treated as part of the same issue as the issue of which the purchased tax-exempt commercial paper was a part.

3.3. *Extension of purchase date for the 180-day holding period*. Section 3.2(3)(b) of Notice 2008-41 (regarding operating rules for purchases pursuant to a qualified tender right) is supplemented to provide that the 90-day period is extended to 180 days with respect to any purchase by or on behalf of a governmental issuer pursuant to a qualified tender right as long as such purchase occurs during the permitted holding period.

3.4. *No terminations of qualified hedges*. For arbitrage purposes under § 148, a qualified hedge with respect to bonds is not deemed terminated under § 1.148-4(h) as a result of the governmental issuer's holding of the hedged bonds during the periods described in sections 3.2 and 3.3 of this notice.

3.5. *Coordination with proposed reissuance regulations*. Issuers that apply the proposed regulations to a bond may apply sections 3.2 and 3.4 of this notice to that bond. In addition, issuers that apply the proposed regulations to a bond may apply § 1.150-3(c)(2) of the proposed regulations by extending the 90-day period referenced therein to 180 days, provided that the acquisition of the qualified tender bond occurs within the permitted holding period.

3.6. *No inferences on law*. This notice provides administrative relief in furtherance of public policy to promote liquidity and stability in the short-term tax-exempt bond market. Except with respect to the administrative relief expressly provided in this notice, no inference should be drawn from this notice regarding any other Federal tax issues affecting tax-exempt bonds or any other security. In addition, this notice is not intended to address any other Federal tax issue implicated in the transactions described in this notice allowing governmental issuers to purchase their own tax-exempt bonds on a temporary basis in prescribed circumstances.

SECTION 4. EFFECT ON OTHER DOCUMENTS

This notice modifies and supplements Notice 2008-41.

SECTION 5. EFFECTIVE DATE

This notice is effective May 4, 2020. Issuers may apply this notice retroactively to purchases on or after January 1, 2020.

SECTION 6. DRAFTING INFORMATION

The principal authors of this notice are Johanna Som de Cerff and Zoran Stojanovic of the Office of Associate Chief Counsel (Financial Institutions and Products). However, other personnel from the IRS and the Treasury Department participated in its development. For further information regarding this notice, contact Mr. Stojanovic at (202) 317-6980 (not a toll-free number).

COVID-19 GUIDANCE UNDER § 125 CAFETERIA PLANS AND RELATED TO HIGH DEDUCTIBLE HEALTH PLANS

Notice 2020-29

I. PURPOSE AND OVERVIEW

To assist with the nation's response to the 2019 Novel Coronavirus outbreak (COVID-19), this notice provides for increased flexibility with respect to mid-year elections under a § 125 cafeteria plan during calendar year 2020 related to employer-sponsored health coverage, health Flexible Spending Arrangements (health FSAs), and dependent care assistance programs. This notice also provides increased flexibility with respect to grace periods to apply unused amounts in health FSAs to medical care expenses incurred through December 31, 2020, and unused amounts in dependent care assistance programs to dependent care expenses incurred through December 31, 2020.

As described more fully below, this notice provides that –

- For mid-year elections made during calendar year 2020, a § 125 cafeteria plan may permit employees who are eligible to make salary reduction contributions under the plan to: (1) with respect to employer-sponsored health coverage, (a) make a new election on a prospective basis, if the employee initially declined to elect employer-sponsored health coverage; (b) revoke an existing election and make a new election to enroll in different health coverage sponsored by the same employer on a prospective basis; and (c) revoke an existing election on a prospective basis, provided that the employee attests in writing that the employee is enrolled, or immediately will enroll, in other health coverage not sponsored by the employer; (2) revoke an election, make a new election, or decrease or increase an existing election applicable to a health FSA on a prospective basis; and (3) revoke an election, make a new election, or decrease or increase an existing election regarding a dependent care assistance program on a prospective basis;
- For unused amounts remaining in a health FSA or a dependent care assistance program under the § 125 cafeteria plan as of the end of a grace period or plan year ending in 2020, a § 125 cafeteria plan may permit employees to apply those unused amounts to pay or reimburse medical care expenses or dependent care expenses, respectively, incurred through December 31, 2020; and
- The relief provided in Notice 2020-15, 2020-14 IRB 559 regarding high deductible health plans (HDHPs) and expenses related to COVID-19, and in section 3701 of the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) (P.L. 116-136, 134 Stat. 281 (March 27, 2020)) regarding an exemption for telehealth services, may be applied retroactively to January 1, 2020.

II. BACKGROUND

A. Elections Under a § 125 Cafeteria Plan

Section 125(d)(1) of the Internal Revenue Code (Code) defines a § 125 cafeteria plan as a written plan maintained by an employer under which all participants are employees, and all participants may choose among two or more benefits consisting of cash and qualified benefits. Subject to certain exceptions, § 125(f) defines a qualified benefit as any benefit which, with the application of § 125(a), is not includable in the gross income of the employee by reason of an express provision of the Code. Qualified benefits that may be provided under a § 125 cafeteria plan include employer-provided accident and health plans excludable under §§ 106 and 105(b), health FSAs excludable under §§ 106 and 105(b), and dependent care assistance programs excludable under § 129.

Elections regarding qualified benefits under a § 125 cafeteria plan generally must be irrevocable and must be made prior to the first day of the plan year, except as provided under Treas. Reg. § 1.125-4.[1] Treas. Reg. § 1.125-4 provides that a § 125 cafeteria plan may permit an employee to revoke an election during a period of coverage and to make a new election under certain circumstances, such as if the employee experiences a change in status or there are significant changes in the cost of coverage. Section 125 does not require a § 125 cafeteria plan to permit the mid-year election changes allowed under Treas. Reg. § 1.125-4.

Due to the nature of the public health emergency posed by COVID-19 and unanticipated changes in the need for medical care, some employers have indicated a willingness to offer employees who initially declined to elect employer-sponsored health coverage an opportunity to elect health coverage or allow employees enrolled in employer-sponsored health coverage to enroll in different health coverage offered by the same employer or drop their existing employer-sponsored health coverage to enroll in other health coverage not offered by their employer (for example, coverage offered by their spouse's employer). In addition, some employees may have an increase or decrease in medical expenses due to unanticipated changes in the need for or availability of medical

[1] In contrast, for qualified transportation fringe benefits under § 132(f) (which pursuant to § 125(f)(1) may not be offered under a § 125 cafeteria plan), Treas. Reg. § 1.132-9, Q&A 14 provides that employees may change or revoke compensation reduction elections related to the qualified transportation fringe benefits under § 132(f) before the employee is able currently to receive the cash or other taxable amount at the employee's discretion (generally before the beginning of a pay period).

care and may wish to increase or decrease amounts in their health FSAs. Further, some employees may have an increase or decrease in the need for dependent care assistance due to the unanticipated closure of schools and child care providers and changes to the employee's work location or schedule. Depending on an employee's circumstances, the exceptions set forth in Treas. Reg. § 1.125-4 may not apply with respect to election changes that employees may wish to request for employer-sponsored health coverage, health FSAs, and dependent care assistance programs for reasons related to the COVID-19 public health emergency.

B. Health FSAs and Dependent Care Assistance Programs

Under the carryover rule, a § 125 cafeteria plan may permit the carryover of unused amounts remaining in a health FSA as of the end of a plan year to pay or reimburse a participant for medical care expenses incurred during the following plan year, subject to the carryover limit (currently $550). See Notice 2013-71, 2013-47 IRB 532, and Notice 2020-33, 2020-22 IRB 868. Under the grace period rule, a § 125 cafeteria plan may permit a participant to apply unused amounts (including amounts remaining in a health FSA or dependent care assistance program) at the end of a plan year to pay expenses incurred for those same qualified benefits during the period of up to two months and 15 days immediately following the end of the plan year. See Notice 2005-42, 2005-1 C.B. 1204, and Prop. Treas. Reg. § 1.125-1(e). For a health FSA, a § 125 cafeteria plan may adopt a carryover or a grace period (or neither), but may not adopt both features. See Notice 2013-71.

Due to the nature of the public health emergency posed by COVID-19, in particular unanticipated changes in the availability of certain medical care and dependent care, employees may be more likely to have unused health FSA amounts or dependent care assistance program amounts (or have larger unused health FSA amounts or dependent care assistance program amounts) as of the end of plan years, or grace periods, ending in 2020 and may wish to have an extended period during which to apply their unused health FSA amounts or dependent care assistance program amounts to pay or reimburse medical care expenses or dependent care expenses.

C. Impact of Health FSA Reimbursements on Eligibility to Contribute to an HSA

Section 223 permits eligible individuals to establish and contribute to health savings accounts (HSAs). Pursuant to § 223(c)(1)(A), an eligible individual is, with respect to any month, any individual if (i) such individual is covered under an HDHP as of the first day of such month, and (ii) such individual is not, while covered under an HDHP, covered under any health plan which is not an HDHP, and which provides coverage for any benefit which is covered under the HDHP. An HDHP is a health plan that satisfies the minimum annual deductible requirement and maximum out-of-pocket expenses requirement under § 223(c)(2)(A).

Coverage by a general purpose health FSA is coverage by a health plan that disqualifies an otherwise eligible individual from contributing to an HSA, although coverage by a limited purpose health FSA would not do so.[2] See Rev. Rul. 2004-45, 2004-1 C.B. 971. Similarly, a telemedicine arrangement generally constitutes a health plan or insurance that provides coverage before the minimum annual deductible is met, and provides coverage that is not disregarded coverage or preventive care, which would generally disqualify an otherwise eligible individual from contributing to an HSA. However, section 3701 of the CARES Act amended § 223 of the Code to temporarily allow HSA-eligible HDHPs to cover telehealth and other remote care services. See section IV.B. of this notice for more details.

III. RELIEF

A. Elections Under a § 125 Cafeteria Plan

This notice provides temporary flexibility for § 125 cafeteria plans to permit employees to make certain prospective mid-year election changes for employer-sponsored health coverage, health FSAs, and dependent care assistance programs during calendar year 2020 that the plan chooses to permit. Specifically, an employer, in its discretion, may amend one or more of its § 125 cafeteria plans (including limiting the period during which election changes may be made) to allow each employee who is eligible to make salary reduction contributions under the plan to make prospective election changes (including an initial election) during calendar year 2020 regarding employer-sponsored health coverage, a health FSA, or a dependent care assistance program, regardless of whether the basis for the election change satisfies the criteria set forth in Treas. Reg. § 1.125-4. In particular, an employer may amend one or more of its § 125 cafeteria plans to allow employees to: (1) make a new election for employer-sponsored health coverage on a prospective basis, if the employee initially declined to elect employer-sponsored health coverage; (2) revoke an existing election for employer-sponsored health coverage and make a new election to enroll in different health coverage sponsored by the same employer on a prospective basis (including changing enrollment from self-only coverage to family coverage); (3) revoke an existing election for employer-sponsored health coverage on a prospective basis, provided that the employee attests in writing that the employee is enrolled, or immediately will enroll, in other health coverage not sponsored by the employer; (4) revoke an election, make a new election, or decrease or increase an existing election regarding a health FSA on a prospective basis; and (5) revoke an election, make a new election, or decrease

[2] Notice 2005-86, 2005-49 IRB 1075 clarifies that coverage by a general purpose health FSA during a grace period is health coverage that disqualifies an otherwise eligible individual from contributing to an HSA during that period. However, Notice 2005-86 provides methods an employer can use to amend the health FSA for the grace period so it does not disqualify employees from contributing to an HSA during that period.

or increase an existing election regarding a dependent care assistance program on a prospective basis.

To accept an employee's revocation of an existing election for employer-sponsored health coverage, the employer must receive from the employee an attestation in writing that the employee is enrolled, or immediately will enroll, in other comprehensive health coverage not sponsored by the employer. The employer may rely on the written attestation provided by the employee, unless the employer has actual knowledge that the employee is not, or will not be, enrolled in other comprehensive health coverage not sponsored by the employer. The following is an example of an acceptable written attestation:

> Name: ______________________
> (and other identifying information requested by the employer for administrative purposes).
> I attest that I am enrolled in, or immediately will enroll in, one of the following types of coverage: (1) employer-sponsored health coverage through the employer of my spouse or parent; (2) individual health insurance coverage enrolled in through the Health Insurance Marketplace (also known as the Health Insurance Exchange); (3) Medicaid; (4) Medicare; (5) TRICARE; (6) Civilian Health and Medical Program of the Department of Veterans Affairs (CHAMPVA); or (7) other coverage that provides comprehensive health benefits (for example, health insurance purchased directly from an insurance company or health insurance provided through a student health plan).
> Signature: ______________________

An employer utilizing this relief under § 125 is not required to provide unlimited election changes but may, in its discretion, determine the extent to which such election changes are permitted and applied, provided that any permitted election changes are applied on a prospective basis only, and the changes to the plan's election requirements do not result in failure to comply with the nondiscrimination rules applicable to § 125 cafeteria plans. In determining the extent to which election changes are permitted and applied, an employer may wish to consider the potential for adverse selection of health coverage by employees. To prevent adverse selection of health coverage, an employer may wish to limit elections to circumstances in which an employee's coverage will be increased or improved as a result of the election (for example, by electing to switch from self-only coverage to family coverage, or from a low option plan covering in-network expenses only to a high option plan covering expenses in or out of network). Changes to the plan may also implicate other applicable laws, such as notice requirements under Title I of the Employee Retirement Income Security Act of 1974, with which any changes should comply. With respect to mid-year election changes for employer-sponsored coverage, this relief applies to both employers sponsoring self-insured plans and employers sponsoring insured plans. With respect to health FSAs, this relief applies to all health FSAs, including limited purpose health FSAs compatible with HSAs. In addition, with respect to health FSAs and dependent care assistance programs, employers are permitted to limit mid-year elections to amounts no less than amounts already reimbursed.

This relief may be applied retroactively to periods prior to the issuance of this notice and on or after January 1, 2020, to address a § 125 cafeteria plan that, prior to the issuance of this notice, permitted mid-year election changes for employer-sponsored health coverage, health FSAs, or dependent care assistance programs that otherwise are consistent with the requirements for the relief provided in this notice.

B. Extended Claims Period for Health FSAs and Dependent Care Assistance Programs

This notice also provides flexibility for a § 125 cafeteria plan to provide an extended period to apply unused amounts remaining in a health FSA or dependent care assistance program to pay or reimburse medical care expenses or dependent care expenses. Specifically, an employer, in its discretion, may amend one or more of its § 125 cafeteria plans to permit employees to apply unused amounts remaining in a health FSA or a dependent care assistance program as of the end of a grace period ending in 2020 or a plan year ending in 2020 to pay or reimburse expenses incurred for the same qualified benefit through December 31, 2020. For example, if an employer sponsors a § 125 cafeteria plan with a health FSA that has a calendar year plan year and provides for a grace period ending on March 15 immediately following the end of each plan year, the employer may amend the plan to permit employees to apply unused amounts remaining in an employee's health FSA as of March 15, 2020, to reimburse the employee for medical care expenses incurred through December 31, 2020.[3] This relief applies to all health FSAs, including limited purpose health FSAs compatible with HSAs. However, health FSA amounts may only be used for medical care expenses, and dependent care assistance program amounts may only be used for dependent care expenses. The extension of time for incurring claims is available both to § 125 cafeteria plans that have a grace period, and plans that provide for a carryover, notwithstanding Notice 2013-71, which otherwise continues in effect and provides that health FSAs can either adopt a grace period or provide for a carryover amount but cannot have both. The following examples illustrate how a plan with a July 1 plan year that allows a $500 carryover would implement the extended period for incurring claims allowed by this notice:

Example 1. Employer provides a health FSA under a § 125 cafeteria plan that allows a $500 carryover for the 2019 plan year (July 1, 2019 to June 30, 2020). Pursuant to this notice and Notice 2020-33, Employer amends the plan to adopt a $550 (indexed) carryover beginning with the 2020 plan year, and also amends the plan to adopt the temporary extended period for incurring claims with respect to the 2019 plan year, allowing for claims incurred prior to January 1, 2021, to be paid with respect to amounts from the 2019 plan year.

Employee A has a remaining balance in his health FSA for the 2019 plan year of $2,000 on June 30, 2020, because a scheduled non-emergency

[3] Certain plans would not need the relief provided in this notice. For example, a plan with a plan year ending on or after October 31, 2020, continues to be able to provide a grace period of up to two months and 15 days, which would allow the reimbursement of claims incurred after December 31, 2020.

procedure was postponed. For the 2020 plan year beginning July 1, 2020, Employee A elects to contribute $2,000 to his health FSA. Employee A is able to reschedule the procedure before December 31, 2020 and, between July 1, 2020 and December 31, 2020, incurs $1,900 in medical care expenses. The health FSA may reimburse Employee A $1,900 from the $2,000 remaining in his health FSA at the end of the 2019 plan year, leaving $100 unused from the 2019 plan year. Under the plan terms that provide for a carryover, Employee A is allowed to use the remaining $100 in his health FSA until June 30, 2021, to reimburse claims incurred during the 2020 plan year. Employee A may be reimbursed for up to $2,100 ($2,000 contributed to the health FSA for the 2020 plan year plus $100 carryover from the 2019 plan year) for medical care expenses incurred between January 1, 2021 and June 30, 2021. In addition, Employee A may carry over to the 2021 plan year beginning July 1, 2021 up to $550 of any remaining portion of that $2,100 after claims are processed for the 2020 plan year that began July 1, 2020. A grace period is not available for the plan year ending June 30, 2021.

Example 2. Same facts as Example 1, except that Employee B has a remaining balance in his health FSA for the 2019 plan year of $1,250 on June 30, 2020. For the 2020 plan year beginning July 1, 2020, Employee B elects to contribute $1,200 to his health FSA. Between July 1, 2020 and December 31, 2020, Employee B incurs $600 in medical care expenses. The health FSA may reimburse Employee B $600 from the $1,250 remaining in his health FSA at the end of the 2019 plan year, leaving $650 unused from the 2019 plan year. Under the plan terms, Employee B is allowed to use $500[4] of the $650 unused amount from the 2019 plan year to reimburse claims incurred during the 2020 plan year, and the remaining $150 will be forfeited. Employee B may be reimbursed for up to $1,700 ($1,200 contributed to the health FSA for the 2020 plan year plus $500 carryover from the 2019 plan year) for medical care expenses incurred between January 1, 2021 and June 30, 2021. In addition, Employee B may carry over to the 2021 plan year beginning July 1, 2021 up to $550 of any remaining unused portion of that $1,700 after claims are processed for the 2020 plan year that began July 1, 2020. A grace period is not available for the plan year ending June 30, 2021.

The extension of the period for incurring claims that may be reimbursed by the health FSA is an extension of coverage by a health plan that is not an HDHP for purposes of determining whether an eligible individual qualifies to make contributions to an HSA (except in the case of an HSA-compatible health FSA, such as a limited purpose health FSA). See section II.C. of this notice. Thus, an individual who had unused amounts remaining at the end of a plan year or grace period ending in 2020 and who is allowed an extended period to incur expenses under a health FSA pursuant to a plan amended in accordance with this notice will not be eligible to contribute to an HSA during the extended period (except in the case of an HSA-compatible health FSA, including a health FSA that is amended to be HSA-compatible).

The relief set forth in this notice may be applied on or after January 1, 2020 and on or before December 31, 2020, provided that any elections made in accordance with this notice apply only on a prospective basis.

C. Plan Amendments

An employer that decides to amend one or more of its § 125 cafeteria plans to provide for mid-year election changes for employer-sponsored health coverage, health FSAs, or dependent care assistance programs in a manner consistent with this notice or to provide for an extended period to apply unused amounts remaining in a health FSA or a dependent care assistance program to pay or reimburse medical care expenses or dependent care expenses in a manner consistent with this notice must adopt a plan amendment. In addition, an employer that decides to amend its health FSA to provide for an increase in the carryover of unused amounts to the following year in a manner consistent with Notice 2020-33, for the 2020 plan year or plan years thereafter, must adopt a plan amendment.

An amendment for the 2020 plan year must be adopted on or before December 31, 2021, and may be effective retroactively to January 1, 2020, provided that the § 125 cafeteria plan operates in accordance with this notice or Notice 2020-33 or both, as applicable, and the employer informs all employees eligible to participate in the § 125 cafeteria plan of the changes to the plan. Any amendment adopted pursuant to this notice must apply only to mid-year elections made during calendar year 2020, or to an extended period to apply unused health FSA amounts or dependent care assistance program amounts for the payment or reimbursement of medical care expenses or dependent care expenses incurred through December 31, 2020.

IV. MISCELLANEOUS

A. HDHPs and Application of Notice 2020-15

Notice 2020-15 provides that a health plan that otherwise satisfies the requirements to be an HDHP under § 223(c)(2)(A) will not fail to be an HDHP merely because the health plan provides medical care services and items purchased related to testing for and treatment of COVID-19 prior to the satisfaction of the applicable minimum deductible. This notice clarifies that the relief provided in Notice 2020-15 regarding HDHPs and expenses related to testing for and treatment of COVID-19 applies with respect to reimbursements of expenses incurred on or after January 1, 2020. This notice further clarifies that the panel of diagnostic testing for influenza A & B, norovirus and other coronaviruses, and respiratory syncytial virus (RSV) and any items or services required to be covered with zero cost sharing under section 6001 of the Families First Coronavirus Response Act (P.L. 116-127, 134 Stat. 178 (March 18, 2020)), as amended by the CARES Act, are part of testing and treatment for COVID-19 for purposes of Notice 2020-15.

B. HDHPs and Application of Section 3701 of the CARES Act

Section 3701 of the CARES Act amends § 223(c) of the Code to provide a temporary safe harbor for providing coverage for telehealth and other remote care services. As added by the CARES Act, § 223(c)(2)(E) of the Code allows HSA-eligible HDHPs to cover telehealth and other re-

[4] The maximum unused amount remaining in a health FSA from a plan year beginning in 2019 allowed to be carried over to the immediately following plan year beginning in 2020 is $500, whereas the maximum unused amount remaining in a health FSA from a plan year beginning in 2020 allowed to be carried over to the immediately following plan year beginning in 2021 is $550 (20 percent of $2,750, the indexed 2020 limit under § 125(i)). See Notice 2020-33.

mote care services without a deductible or with a deductible below the minimum annual deductible otherwise required by § 223(c)(2)(A) of the Code. Section 3701 of the CARES Act also amends § 223(c)(1)(B)(ii) of the Code to include telehealth and other remote care services as categories of coverage that are disregarded for purposes of determining whether an individual who has other health plan coverage in addition to an HDHP is an eligible individual who may make tax-favored contributions to his or her HSA under § 223 of the Code. Thus, an otherwise eligible individual with coverage under an HDHP may also receive coverage for telehealth and other remote care services outside the HDHP and before satisfying the deductible of the HDHP and still contribute to an HSA. The amendments to § 223 of the Code under section 3701 of the CARES Act are effective March 27, 2020, and apply to plan years beginning on or before December 31, 2021. This notice provides that treatment of telehealth and other remote care services under section 3701 of the CARES Act applies with respect to services provided on or after January 1, 2020, with respect to plan years beginning on or before December 31, 2021. Therefore, for example, an otherwise eligible individual with coverage under an HDHP who also received coverage beginning February 15, 2020 for telehealth and other remote care services under an arrangement that is not an HDHP and before satisfying the deductible for the HDHP will not be disqualified from contributing to an HSA during 2020.

V. DRAFTING INFORMATION

The principal author of this notice is Jennifer Solomon of the Office of Associate Chief Counsel (Employee Benefits, Exempt Organizations, and Employment Taxes), though other Treasury Department and IRS officials participated in its development. For further information on the provisions of this notice, contact Jennifer Solomon at (202) 317-5500 (not a toll-free number).

Section 125 Cafeteria Plans - Modification of Permissive Carryover Rule for Health Flexible Spending Arrangements and Clarification Regarding Reimbursements of Premiums by Individual Coverage Health Reimbursement Arrangements

Notice 2020-33

I. PURPOSE

This notice modifies Notice 2013-71, 2013-47 IRB 532, to increase the carryover limit (currently $500) of unused amounts remaining as of the end of a plan year in a health Flexible Spending Arrangement (health FSA) under a § 125 cafeteria plan that may be carried over to pay or reimburse a participant for medical care expenses incurred during the following plan year. The increase in the amount that can be carried over from one plan year to the next reflects indexing for inflation, and this indexing parallels the indexing applicable to the limit on salary reduction contributions under § 125(i) of the Internal Revenue Code (Code). Second, this notice clarifies the ability of a health plan to reimburse individual insurance policy premium expenses incurred prior to the beginning of the plan year for coverage provided during the plan year. This clarification will assist with the implementation of individual coverage health reimbursement arrangements (individual coverage HRAs).

II. BACKGROUND

Section 125(d)(1) defines a § 125 cafeteria plan as a written plan maintained by an employer under which all participants are employees, and all participants may choose among two or more benefits consisting of cash and qualified benefits. Subject to certain exceptions, § 125(f) defines a qualified benefit as any benefit which, with the application of § 125(a), is not includable in the gross income of the employee by reason of an express provision of the Code. Qualified benefits include employer-provided accident and health plans excludable from gross income under §§ 106 and 105(b), but exclude long term care insurance and certain qualified health plans offered through an Exchange (also referred to as a Marketplace) established under § 1311 of the Patient Protection and Affordable Care Act (the Act).[5]

Qualified health and accident benefits provided under a § 125 cafeteria plan and reimbursements of medical care expenses by an HRA or any other accident and health plan are subject to the rules for the exclusions from gross income under §§ 105 and 106. An amount generally will be treated as received under an accident and health plan only if the employee was covered by the plan on the date the employee became sick or injured. Treas. Reg. § 1.105-5. Thus, only reimbursements for medical care expenses incurred by a participant during the plan year may be excluded from income and wages under §§ 105 and 106.

Section 125(i) provides that, beginning in 2013, a health FSA is not treated as a qualified benefit unless the § 125 cafeteria plan limits each employee's salary reduction contribution to the health FSA to no more than $2,500 per taxable year (as indexed for cost-of-living adjustments, $2,750 for 2020).[6] Notice 2012-40, 2012-26 IRB 1046, clarifies that the term "taxable year" in § 125(i) refers to the plan year of the § 125 cafeteria plan, so that the limit is applicable beginning with the first day of the first plan year beginning in 2013.

A. The permissive carryover rule

Pursuant to § 125(d)(2)(A), a § 125 cafeteria plan generally does not include any plan that provides for deferred compensation. Consistent with this statutory rule, proposed regulations under § 125 (that predate the enactment of the Act and provide that taxpayers may rely upon them

[5] Public Law 111-148 (124 Stat. 1029 (2010)), amended by §§ 10104 and 10203 of the Act.

[6] Revenue Procedure 2019-44, 2019-47 IRB 1093.

pending further guidance) generally prohibit participants from using contributions made for one plan year to purchase a benefit that will be provided in a subsequent plan year because using contributions in this manner would result in a deferral of compensation. To satisfy the statutory requirement, and in reliance on the proposed regulations, plans adopted a "use-or-lose" rule under which unused benefits or contributions remaining as of the end of the plan year (referred to in this notice as "unused amount(s)") are forfeited. See Prop. Treas. Reg. §§ 1.125-1(c)(7)(C), 1.125-1(o), and 1.125-5(c). To address the need for a period after the end of the plan year during which participants may submit documentation for expenses incurred throughout the entire plan year, the proposed regulations provide for a "run-out period." A "run-out period" is a period immediately following the end of a plan year during which a participant can submit a claim for reimbursement of expenses incurred for qualified benefits during the plan year or, in the case of a plan using the grace period rule (described in the following paragraph), such a period immediately following the end of the grace period. See Prop. Treas. Reg. § 1.125-1(f). Plans commonly rely on this rule to calculate the unused amounts as of the end of a health FSA's plan year. The unused amounts are calculated as the amounts that remain after medical care expenses have been reimbursed at the end of the plan's run-out period for that plan year.

In 2005, the Department of the Treasury (Treasury Department) and the Internal Revenue Service (IRS) liberalized the use-or-lose rule by providing a grace period rule. Under the grace period rule, a § 125 cafeteria plan may permit a participant to apply unused amounts (including amounts remaining in a health FSA) to pay expenses incurred for certain qualified benefits during the period of up to two months and 15 days immediately following the end of the plan year. See Notice 2005-42, 2005-1 C.B. 1204, and Prop. Treas. Reg. § 1.125-1(e). This exception is based on other Code provisions and Treasury regulations that do not treat certain compensation arrangements as providing for deferred compensation if the compensation is paid no later than the fifteenth day of the third month after the taxable year in which the services are performed. See, e.g., Treas. Reg. § 1.404(b)-1T, Q&A-2.

Notice 2013-71 provided a further liberalization permitting a § 125 cafeteria plan to allow up to $500 of any unused amount in a participant's health FSA as of the end of a plan year to be paid or reimbursed to the participant for medical care expenses incurred in the immediately following plan year (the "permissive carryover" rule). In addition to the unused amounts of up to $500 that a plan may permit a participant to carry over to the next year, the plan may also permit the participant to elect up to the maximum amount of contributions through salary reduction permitted under § 125(i) for that year. Thus, under the liberalization provided through Notice 2013-17, the carryover of up to $500 does not count against, or otherwise affect, the indexed $2,500 limit on salary reduction contributions applicable to each plan year. Although the maximum unused amount allowed to be carried over in any plan year is $500, the plan may specify a lower amount as the permissible maximum carryover (and the plan sponsor has the option of not permitting any carryover at all).

Notice 2013-71, in permitting a carryover of $500, specified that a plan adopting a carryover provision is not permitted to also provide a grace period with respect to health FSAs. Nor is the plan, for any plan year, permitted to allow a participant to elect a salary reduction contribution for health FSA benefits of more than the indexed $2,500 limit, or permitted to reimburse claims incurred during the plan year that exceed the applicable indexed $2,500 salary reduction contribution limit (and any nonelective employer contributions, often referred to as flex credits), plus the carryover amount of up to $500. If an employer adopts a carryover provision, the same carryover limit must apply to all plan participants. Also, a § 125 cafeteria plan is not permitted to allow unused amounts relating to a health FSA to be cashed out or converted to any other taxable or nontaxable benefit as this would result in deferral of compensation prohibited by § 125(a)(2)(A). Rather, unused amounts relating to a health FSA may be used only to pay or reimburse certain § 213(d) medical care expenses (excluding health insurance, long-term care services, or long-term care insurance). See Prop. Treas. Reg. § 1.125-1(q).

With respect to a participant, the amount that may be carried over to the following plan year is equal to the lesser of (1) any unused amounts from the immediately preceding plan year, or (2) $500 (or a lower amount specified in the plan). To prevent deferral of compensation, any unused amount in excess of $500 (or a lower amount specified in the plan) as of the end of the run-out period for the plan year is forfeited. Any unused amount in a participant's health FSA as of termination of employment also is forfeited (unless, if applicable, the participant elects COBRA continuation coverage with respect to the health FSA).

When Notice 2013-71 was issued, $500 represented 20 percent of the maximum allowed salary reduction amount under § 125(i). While the $2,500 maximum allowed salary reduction amount is indexed for inflation under § 125(i)(2), Notice 2013-71 did not provide for any adjustment to the maximum $500 carryover amount. The indexed amount under § 125(i) for 2020 is $2,750.

On June 24, 2019, President Trump issued Executive Order 13877,[7] "Improving Price and Quality Transparency in American Healthcare to Put Patients First," which included an order that the Secretary of Treasury, to the extent consistent with law, issue guidance to increase the amount of funds that can carry over without penalty at the end of the year for flexible spending arrangements. In response to Executive Order 13877, the Treasury Department and the IRS are issuing this notice.

B.Timing of reimbursements by health plans

On October 12, 2017, President Trump issued Executive Order 13813,[8] "Promoting Healthcare Choice and Competition

[7] 84 FR 30849 (June 24, 2019).

[8] 82 FR 48385 (Oct. 17, 2017).

Across the United States," which included directions to the Secretaries of the Treasury, Labor, and Health and Human Services (the Departments) to "consider proposing regulations or revising guidance, to the extent permitted by law and supported by sound policy, to increase the usability of HRAs, to expand employers' ability to offer HRAs to their employees, and to allow HRAs to be used in conjunction with nongroup coverage." In response to Executive Order 13813, the Departments issued regulations allowing HRAs to be "integrated" with individual health insurance coverage or Medicare if certain conditions are satisfied.[9] These HRAs are referred to as individual coverage HRAs[10] and generally are designed to reimburse employees for substantiated premiums for individual health insurance coverage and other medical care expenses.

Individual coverage HRAs are, nonetheless, employer-sponsored health plans and the exclusion from employees' gross income of reimbursements by these HRAs is subject to the requirements of §§ 105 and 106 and the underlying regulations. These requirements include the general rule that only payment or reimbursement for medical care expenses incurred by an employee during the plan year may be excluded from income and wages under §§ 105 and 106. Notwithstanding this general rule, as well as the rule prohibiting the deferral of compensation in a § 125 cafeteria plan, the Treasury Department and the IRS recognized certain practical difficulties and proposed a rule of administrative convenience that would permit amounts contributed by salary reduction from the last month of one plan year of a § 125 cafeteria plan to be applied to pay accident and health insurance premiums for insurance during the first month of the immediately following plan year, if done on a uniform and consistent basis with respect to all participants. See Prop. Treas. Reg. § 1.125-1(p)(5)(i) (upon which taxpayers may rely pending further guidance).

The restriction that a health plan may reimburse only medical care expenses incurred during the plan year raises analogous administrative issues in the case of an individual coverage HRA to the extent that a participant must pay, prior to the first day of a plan year, all or part of the premiums for individual health insurance coverage or Medicare during that plan year. Notice 2017-67, 2017-47 IRB 517, addresses these issues in the context of qualified small employer HRAs (QSEHRAs) under § 9831(d), which are arrangements similar to individual coverage HRAs. In particular, Q&A-52 of Notice 2017-67 provides that, notwithstanding a general rule that a QSEHRA may not reimburse medical care expenses incurred before the eligible employee is provided the QSEHRA, a QSEHRA is permitted to treat a premium expense for a period of coverage as incurred on (1) the first day of each month of coverage on a pro rata basis, (2) the first day of the period of coverage, or (3) the date the premium is paid.

III. GUIDANCE - FSA CARRYOVER AMOUNTS

A. Indexing of maximum carryover amount

As discussed in section II.A., this notice expands the exception to the prohibition on providing deferral of compensation through a § 125 cafeteria plan described in Notice 2013-71, which provides that a § 125 cafeteria plan may allow up to $500 of unused amounts in a participant's health FSA as of the end of a plan year to be carried over to pay or reimburse the participant for medical care expenses incurred in the immediately following plan year. Specifically, this notice increases the maximum $500 carryover amount for a plan year to an amount equal to 20 percent of the maximum salary reduction contribution under § 125(i) for that plan year. Because, by statute, the increase to the § 125(i) limit is rounded to the next lowest multiple of $50, increases to the maximum carryover amount, as the result of that indexing, will be in multiples of $10 (20 percent of any $50 increase to the § 125(i) limit). Thus, the maximum unused amount from a plan year starting in 2020 allowed to be carried over to the immediately following plan year beginning in 2021 is $550 (20 percent of $2,750, the indexed 2020 limit under § 125(i)).

B. Deadline for a written § 125 cafeteria plan amendment to implement indexing of maximum carryover amount for 2020 (or a later year)

As a general rule, an amendment to a § 125 cafeteria plan to increase the carryover limit must be adopted on or before the last day of the plan year from which amounts may be carried over and may be effective retroactively to the first day of that plan year, provided that the § 125 cafeteria plan operates in accordance with the guidance under this notice and informs all employees eligible to participate in the plan of the carryover provision. Because § 125(d)(1) provides that a § 125 cafeteria plan must be a written plan,[11] a § 125 cafeteria plan offering a health FSA may not utilize the increased carryover amount permitted under this notice for a plan year that begins in 2020 (or a later year) unless the plan is written in a manner that incorporates the increase by reference or the plan is timely amended to set forth the increased amount. Accordingly, a plan may be amended to adopt the increased carryover amount for a plan year that begins in 2021, for example, at any time on or before the last day of the plan year that begins in 2021; see section III.C. for a special amendment timing rule for the 2020 plan year. The ability to amend a plan to increase the carryover limit does not include the ability to allow employees to make new elections under the plan (but see relief for the 2020 plan year in section III.C.).

C. Extended period for employee elections for 2020

The final and proposed regulations under § 125 set forth a framework for the timing and amendments of participant elections that ensure the plan meets the requirements of the Code, including that

[9] 84 FR 28888 (June 20, 2019).

[10] Treas. Reg. § 54.9802-4.

[11] See also Prop. Treas. Reg. § 1.125-1(c).

the plan not provide for deferred compensation. Generally, under those regulations, an individual must make § 125 cafeteria plan elections before the start of the plan year, and those plan elections must be irrevocable during the plan year, with limited exceptions that include certain changes in status to prevent the elections from constituting a deferral of compensation in contravention of § 125(d)(2)(A). See Treas. Reg. § 1.125-4 and Prop. Treas. Reg. § 1.125-2. As a result, an individual would be unable to modify his or her election for a health FSA on or after the first day of the 2020 plan year of the § 125 cafeteria plan, notwithstanding that the § 125 cafeteria plan is being amended to adopt the increased carryover amount for the 2020 plan year.

However, the Treasury Department and the IRS are simultaneously issuing a notice that, among other things, for the remainder of 2020, allows employers to permit mid-year elections under a § 125 cafeteria plan regarding a health FSA, including the ability to make an initial election to fund a health FSA, provided the changes are applied only prospectively. See Notice 2020-29, 2020-22 IRB 864. Although Notice 2020-29 permits this flexibility temporarily in response to the public health emergency posed by the 2019 Novel Coronavirus, Notice 2020-29 does not limit the relief to individuals affected by the pandemic. Accordingly, individuals who, during 2020, wish to increase their health FSA contributions, or begin to make health FSA contributions, as a result of the increased carryover amount permitted under this notice may do so in accordance with Notice 2020-29. Although only future salary may be reduced under the revised election, amounts contributed to the health FSA after the revised election may be used for any medical care expense incurred during the first plan year that begins on or after January 1, 2020.

With respect to the requirement to amend the written plan, Notice 2020-29 provides that an amendment under this notice for the 2020 plan year must be adopted on or before December 31, 2021, and may be effective retroactively to January 1, 2020, provided that the employer informs all individuals eligible to participate in the § 125 cafeteria plan of the changes to the plan.

IV. GUIDANCE - TIMING FOR REIMBURSEMENTS BY HEALTH PLANS

As discussed in section II.B. of this notice, a health plan, including a premium-reimbursement plan in a § 125 cafeteria plan or an individual coverage HRA, may not reimburse medical care expenses incurred before the beginning of the plan year and qualify for exclusion from income and wages under §§ 105 and 106. Medical care expenses are treated as incurred when the covered individual is provided the medical care that gives rise to the expense, and not when the amount is billed or paid. This notice provides that a plan is permitted to treat an expense for a premium for health insurance coverage as incurred on (1) the first day of each month of coverage on a pro rata basis, (2) the first day of the period of coverage, or (3) the date the premium is paid. Thus, for example, an individual coverage HRA with a calendar year plan year may immediately reimburse a substantiated premium for health insurance coverage that begins on January 1 of that plan year, even if the covered individual paid the premium for the coverage prior to the first day of the plan year.

V. EFFECT ON OTHER DOCUMENTS

Notice 2013-71 is modified to increase the annual maximum carryover amount allowed for a health FSA consistent with the guidance described above.

VI. INTENT TO REVISE EXISTING REGULATIONS; RELIANCE

The Treasury Department and the IRS intend to revise Prop. Treas. Reg. §§ 1.125-1(o) and 1.125-5(c) to reflect the guidance in this notice. Until the proposed regulations are so revised, taxpayers may rely upon the guidance provided in this notice, which is favorable to taxpayers.

VII. DRAFTING INFORMATION

The principal author of this notice is Christopher Dellana of the Office of Associate Chief Counsel (Employee Benefits, Exempt Organizations, and Employment Taxes). For further information regarding this notice, contact Christopher Dellana at (202) 317-5500 (not a toll-free number).

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26 CFR 601.105: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability.
(Also: Part I, §§ 301, 305, 852, 857; 1.305-1, 1.305-2)

Revenue Procedure 2020-19

SECTION 1. PURPOSE

This revenue procedure provides temporary guidance regarding the treatment of certain stock distributions by publicly offered real estate investment trusts (REITs) and publicly offered regulated investment companies (RICs) under the Internal Revenue Code (Code). Specifically, in recognition of the need for enhanced liquidity during the current period of economic disruption, this revenue procedure modifies the safe harbor provided in Rev. Proc. 2017-45, 2017-35 I.R.B. 216, by temporarily reducing the minimum required aggregate amount of cash that distributee shareholders may receive to not less than 10 percent of the total distribution in order for § 301 of the Code, by reason of § 305(b) of the Code, to apply to such distribution. This temporary modification is effective solely with respect to distributions declared by a publicly offered REIT or publicly offered RIC on or after April 1, 2020, and on or before December 31, 2020.

SECTION 2. BACKGROUND

.01 Rev. Proc. 2017-45 provides a safe harbor for Publicly Offered REITs and Publicly Offered RICs that make a distribution to their shareholders with respect to their stock to ensure that such distributions of stock pursuant to a distribution in which each shareholder may elect to receive up to all of the shareholder's distribution in cash or stock of equivalent value are treated as distributions of property to which § 301 applies by reason of § 305(b). *See generally* Rev. Proc. 2017-45, section 3.12 (defining *Publicly Offered REIT*), section 3.13 (defining *Publicly Offered RIC*), and section 5 (enumerat-

ing safe harbor requirements). Rev. Proc. 2017-45 allows a Publicly Offered REIT or Publicly Offered RIC to eliminate C corporation earnings and profits in order to satisfy the REIT or RIC distribution requirements while maintaining sufficient liquidity. If each condition set forth in sections 5.01 through 5.07 of Rev. Proc. 2017-45 is met, (1) the Internal Revenue Service will treat the stock distribution as a distribution of property under § 301 by reason of § 305(b), and (2) the value of the stock received by any shareholder in lieu of cash will be considered to be equal to the amount of cash which could have been received instead.

.02 Section 5.03 of Rev. Proc. 2017-45 requires that the Cash Limitation Percentage be at least 20 percent. Section 3.05 of Rev. Proc. 2017-45 defines the *Cash Limitation Percentage* as the percentage obtained by dividing (1) the maximum aggregate amount of cash to be distributed to all shareholders as limited by the Publicly Offered REIT's or Publicly Offered RIC's declaration of the distribution, by (2) the amount of cash that would be distributed if each shareholder elected to receive solely cash under their respective Stock-or-Cash Election. Section 3.06 of Rev. Proc. 2017-45 generally defines a *Cash-or-Stock Election* as an election each shareholder may make to receive up to all of the shareholder's entire distribution subject to the election either (1) in cash, or (2) in stock of the distributing corporation of equivalent value as determined under section 5.07 of Rev. Proc. 2017-45.

.03 To enable Publicly Offered REITs and Publicly Offered RICs to conserve capital and thereby enhance their liquidity, this revenue procedure temporarily allows such REITs and RICs to further limit the amount of cash available to be distributed to their shareholders by reducing the Cash Limitation Percentage to 10 percent.

SECTION 3. TEMPORARY REDUCTION OF CASH LIMITATION PERCENTAGE

Section 5.03 of Rev. Proc. 2017-45 is modified by striking "The Cash Limitation Percentage is not less than 20 percent" and inserting "The Cash Limitation Percentage is not less than 10 percent".

SECTION 4. EFFECT ON OTHER DOCUMENTS

This revenue procedure modifies Rev. Proc. 2017-45 solely with respect to distributions declared by a Publicly Offered REIT or Publicly Offered RIC on or after April 1, 2020, and on or before December 31, 2020.

SECTION 5. DRAFTING INFORMATION

The principal author of this revenue procedure is Justin O. Kellar of the Office of Associate Chief Counsel (Corporate). For further information regarding this revenue procedure, contact Justin O. Kellar on (202) 317-6847 (not a toll-free number).

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26 CFR 601.601 Rules and regulations.
(Also: §§ 147, 1.147(f)-1)

Rev. Proc. 2020-21

SECTION 1. PURPOSE

This revenue procedure provides temporary guidance regarding the public approval requirement under § 147(f) of the Internal Revenue Code (Code) for tax-exempt qualified private activity bonds. Specifically, in light of the Coronavirus Disease 2019 (COVID-19) pandemic, this revenue procedure provides that hearings held by teleconference as described in section 4.01 of this revenue procedure will be treated as held in a location that, based on the facts and circumstances, is convenient for residents of the approving governmental unit for the purpose of § 1.147(f)-1(d)(2) of the Income Tax Regulations.

SECTION 2. BACKGROUND

.01 Pursuant to § 147(f), tax-exempt qualified private activity bonds are subject to a public approval requirement. Except for refunding bonds described in § 147(f)(2)(D), a bond issue must be approved by the governmental unit issuing the bonds (or on behalf of which such bonds are issued) and by the governmental unit having jurisdiction over the area in which any facility to be financed by the issue is located. Under § 147(f)(2)(B), an issue will be treated as having been approved by any governmental unit if the issue is approved by the applicable elective representative of the governmental unit after a public hearing following reasonable public notice, or by voter referendum of the governmental unit.

.02 Section 1.147(f)-1(d)(1) provides that public hearing means a forum providing a reasonable opportunity for interested individuals to express their views, orally or in writing, on the proposed issue of bonds and the location and nature of the proposed project to be financed. Section 1.147(f)-1(d)(2) provides that the public hearing must be held in a location that, based on the facts and circumstances, is convenient for residents of the approving governmental unit. The location is presumed convenient for residents of the governmental unit if it is located in the approving governmental unit's capital or seat of government. Further, if more than one governmental unit is required to hold a public hearing, the hearings may be combined as long as the combined hearing affords the residents of all of the participating governmental units a reasonable opportunity to be heard. The location of any combined hearing is presumed convenient for residents of each participating governmental unit if it is no farther than 100 miles from the seat of government of each participating governmental unit beyond whose geographic jurisdiction the hearing is conducted.

.03 In light of the COVID-19 pandemic, state and local governmental units are currently seeking alternatives to in-person hearings held to meet the public approval requirement. Comments received by the Internal Revenue Service have requested guidance on the use of telephone or internet-based meeting technology to hold hearings. Section 4 of this revenue procedure provides this guidance.

SECTION 3. SCOPE

This revenue procedure applies to hearings held telephonically for the purpose of

satisfying the public approval requirement under § 147(f).

SECTION 4. APPLICATION

.01 *Telephonic hearings permitted*. A hearing conducted during the period described in section 4.02 of this revenue procedure that is held by teleconference accessible to the residents of the approving governmental unit by calling a toll-free telephone number will be treated as held in a location that, based on the facts and circumstances, is convenient for residents of the approving governmental unit for the purpose of § 1.147(f)-1(d)(2). Provided the requirements of the preceding sentence are satisfied, governmental units are not precluded from offering additional access to the hearing by other telephone numbers or by internet-based meeting technology.

.02 *Time period*. The period described in this section 4.02 is the period beginning on May 4, 2020 and ending on December 31, 2020.

.03 *Supplemental public notice*. Solely for a public hearing for which public notice that meets the requirements of § 1.147(f)-1(d)(4) was provided on or before May 11, 2020, the public notice will continue to meet the requirements of § 1.147(f)-1(d)(4) if (1) the hearing is held in the manner described in section 4.01 of this revenue procedure and (2) the toll-free telephone number required under section 4.01 of this revenue procedure is provided at least 48 hours prior to the hearing by a governmental website posting that meets the requirements of § 1.147(f)-1(d)(4)(iii).

SECTION 5. EFFECTIVE DATE

This revenue procedure is effective May 4, 2020. Issuers may apply this revenue procedure retroactively to public hearings held telephonically before May 4, 2020, in response to the COVID-19 pandemic.

SECTION 6. DRAFTING INFORMATION

The principal author of this revenue procedure is Johanna Som de Cerff of the Office of the Associate Chief Counsel (Financial Institutions & Products). For further information regarding this revenue procedure, contact Ms. Som de Cerff at 202-317-6980 (not a toll-free number).

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26 CFR 601.602: Tax forms and instructions.
(Also: Part I, §§1503(d); 1.1503(d)-1)

Rev. Proc. 2020-30

SECTION 1. PURPOSE

As a result of travel restrictions and disruptions resulting from the global outbreak of the virus that causes COVID-19 (the "COVID-19 Emergency"), individuals may temporarily conduct activities in a country other than the United States or in a territory of the United States (any such country or territory, a "foreign country") that would not otherwise have been conducted there. Absent guidance such as this revenue procedure, there may be uncertainty regarding whether these activities give rise to a foreign branch separate unit for purposes of the dual consolidated loss rules under section 1503(d) or an obligation to file Form 8858 ("Information Return of U.S. Persons With Respect to Foreign Disregarded Entities (FDEs) and Foreign Branches (FBs)"). This revenue procedure provides that certain activities are not taken into account for either of these purposes.

SECTION 2. BACKGROUND

.01 *Travel disruptions resulting from the COVID-19 Emergency.* Restrictions and other measures in response to, and disruptions resulting from, the COVID-19 Emergency may significantly restrict the cross-border movement of an individual, including an individual who intended to return to the United States from a foreign country. *See generally* Rev. Proc. 2020-20, section 2.01 (discussing restrictions and disruptions that may restrict the ability of an individual to leave the United States). These travel disruptions (collectively, "COVID-19 Emergency Travel Disruptions") may include transportation disruptions, shelter-in-place orders, quarantines, border closures, and recommendations to implement social distancing and limit exposure to public spaces.

.02 *Dual consolidated loss rules*. In general, the dual consolidated loss rules under section 1503(d) limit the ability of a domestic corporation to use a "dual consolidated loss," which is defined to include a net loss attributable to a "foreign branch separate unit." *See* §§1.1503(d)-1(b)(4) and (5) and 1.1503(d)-4(b). A foreign branch separate unit generally means a business operation outside the United States that, if carried on by a U.S. person, would constitute a foreign branch as defined in §1.367(a)-6T(g)(1). *See* §1.1503(d)-1(b)(4)(i)(A).

.03 *Form 8858.* Form 8858 ("Information Return of U.S. Persons With Respect to Foreign Disregarded Entities (FDEs) and Foreign Branches (FBs)") is used by certain U.S. persons that directly or indirectly operate a foreign branch. Form 8858 and related schedules are used to satisfy the reporting requirements of sections 6011, 6012, 6031, and 6038, and related regulations. For purposes of Form 8858, a foreign branch means a foreign branch as defined in §1.367(a)-6T(g)(1), as well as a qualified business unit as defined in §1.989(a)-1(b)(2)(ii) (generally providing that activities qualify as a qualified business unit if the activities constitute a trade or business and a separate set of books and records is maintained with respect to the activities). *See* Instructions for Form 8858.

.04 *Foreign branch definition.* Section 1.367(a)-6T(g)(1) defines a foreign branch as activities that, based on all the facts and circumstances, constitute an integral business operation carried on by a U.S. person outside the United States. For this purpose, evidence of the existence of a foreign branch includes, but is not limited to, the existence of a separate set of books and records and the existence of an office or other fixed place of business used by employees or officers of the U.S. person in carrying out business activities outside the United States. *Id*. Further, activities outside the United States are deemed to constitute a foreign branch if the activities constitute a permanent establishment under the terms of a treaty between the United States and the foreign country in which the activities are carried out. *Id*. Whether a taxpayer has a permanent establishment in a foreign country is determined under the rules of the relevant U.S. income tax treaty.

SECTION 3. ACTIVITIES NOT TAKEN INTO ACCOUNT IN DETERMINING A FOREIGN BRANCH SEPARATE UNIT OR FORM 8858 FILING OBLIGATION

.01 *In general.* "Temporary activities," as defined in section 3.02 of this revenue procedure, will not be taken into account for purposes of determining whether a domestic corporation has a foreign branch separate unit, or whether a U.S. person is required to file a Form 8858. As a result, temporary activities will not give rise to a foreign branch separate unit under section 1503(d). In addition, for purposes of Form 8858, temporary activities will not give rise to a foreign branch (that is, either a foreign branch as defined in §1.367(a)-6T(g)(1) or a qualified business unit as defined in §1.989(a)-1(b)(2)(ii)). Thus, temporary activities will not give rise to an obligation of a U.S. person to file a Form 8858, including an obligation to file a Form 8858 by attaching the Form 8858 to a Form 5471 with respect to a controlled foreign corporation or to a Form 8865 with respect to a controlled foreign partnership.

.02 *Temporary activities.* The term temporary activities means activities of a taxpayer conducted by one or more individuals in a foreign country during any single consecutive period of up to 60 calendar days selected by the taxpayer within calendar year 2020, to the extent that the individual or individuals were temporarily present in the foreign country during the period and the activities would not have been conducted in the foreign country but for COVID-19 Emergency Travel Disruptions with respect to the individual or individuals. For example, if an individual employed by or acting on behalf of a domestic corporation traveled to a foreign country on March 1, 2020, and as a result of restrictions implemented by, or recommendations of, the U.S. government or a foreign government in response to the COVID-19 Emergency remained in the foreign country until April 27, 2020, then any activities conducted by the individual on behalf of the domestic corporation during such period would constitute temporary activities, to the extent that, but for the restrictions or recommendations, the individual would have left, and would not have conducted the activities in, the foreign country.

.03 *Documentation*. A domestic corporation that for purposes of section 1503(d), or a U.S. person that for purposes of Form 8858, treats activities as temporary activities should retain contemporaneous documentation to establish that the activities are temporary activities (including to establish the up-to-60-day period described in section 3.02 of this revenue procedure during which the activities occur), and should be prepared to provide the documentation to the Internal Revenue Service upon request.

.04 *No inference.* No inference should be drawn from this revenue procedure as to whether activities of a taxpayer that are conducted by one or more individuals in a foreign country during calendar year 2020 and that would be temporary activities without regard to the 60-day limit described in section 3.02 of this revenue procedure give rise to a foreign branch as defined in §1.367(a)-6T(g)(1) or a qualified business unit as defined in §1.989(a)-1(b)(2)(ii).

SECTION 4. DRAFTING INFORMATION

The principal author of this revenue procedure is Shane McCarrick of the Office of Associate Chief Counsel (International). For further information regarding this revenue procedure, contact Mr. McCarrick at (202) 317-6937 (not a toll-free number).

Part IV

Notice of Proposed Rulemaking

Effect of Section 67(g) on Trusts and Estates

REG-113295-18

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations clarifying that the following deductions allowed to an estate or non-grantor trust are not miscellaneous itemized deductions: costs paid or incurred in connection with the administration of an estate or non-grantor trust that would not have been incurred if the property were not held in the estate or trust, the personal exemption of an estate or non-grantor trust, the distribution deduction for trusts distributing current income, and the distribution deduction for estates and trusts accumulating income. Therefore, these deductions are not affected by the suspension of the deductibility of miscellaneous itemized deductions for taxable years beginning after December 31, 2017, and before January 1, 2026. The proposed regulations also provide guidance on determining the character, amount, and allocation of deductions in excess of gross income succeeded to by a beneficiary on the termination of an estate or non-grantor trust. These proposed regulations affect estates, non-grantor trusts (including the S portion of an electing small business trust), and their beneficiaries.

DATES: Written or electronic comments and requests for a public hearing must be received by June 25, 2020.

ADDRESSES: Commenters are strongly encouraged to submit public comments electronically. Submit electronic submissions via the Federal eRulemaking Portal at www.regulations.gov (indicate IRS and REG-113295-18) by following the online instructions for submitting comments. Once submitted to the Federal eRulemaking Portal, comments cannot be edited or withdrawn. The IRS expects to have limited personnel available to process public comments that are submitted on paper through mail. Until further notice, any comments submitted on paper will be considered to the extent practicable. The Department of the Treasury (Treasury Department) and the IRS will publish for public availability any comment submitted electronically, and to the extent practicable on paper, to its public docket.

Send paper submissions to: CC:PA:LPD:PR (REG-113295-18), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, D.C. 20044.

Requests for a public hearing must be submitted as prescribed in the "**Comments and Requests for a Public Hearing**" section.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Margaret Burow, (202) 317-5279; concerning submissions of comments and/or requests for a public hearing, Regina Johnson, (202) 317-5177 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed amendments to the Income Tax Regulations (26 CFR part 1) under sections 67 and 642 of the Internal Revenue Code (Code).

I. Section 67(g)

Section 67(g) was added to the Code on December 22, 2017, by section 11045(a) of the Tax Cuts and Jobs Act, Public Law 115-97, 131 Stat. 2054, 2088 (2017) (Act). Section 67(g) prohibits individual taxpayers from claiming miscellaneous itemized deductions for any taxable year beginning after December 31, 2017, and before January 1, 2026.

For purposes of subtitle A of the Code, an individual's *adjusted gross income* is defined in section 62(a) as gross income minus the deductions listed in section 62(a)(1) through (21). Individuals then may subtract itemized deductions from adjusted gross income to arrive at taxable income. *See* section 63(a). Section 63(d) defines *itemized deductions* as deductions allowable under chapter 1 of subtitle A of the Code, other than (1) deductions allowable in arriving at adjusted gross income, (2) deductions for personal exemptions provided by section 151, and (3) the deduction under section 199A. A subset of these itemized deductions, identified as miscellaneous itemized deductions, are subject to special rules. Prior to the Act, miscellaneous itemized deductions were allowable for any taxable year only if the sum of such deductions exceeded two percent of adjusted gross income. *See* section 67(a). Section 67(b) defines *miscellaneous itemized deductions* as itemized deductions other than those listed in section 67(b)(1) through (12).

II. *Section 67(e)*

Section 67(e) provides that an estate or trust computes its adjusted gross income in the same manner as that of an individual, except that the following additional deductions are treated as allowable in arriving at adjusted gross income: (1) the deductions for costs which are paid or incurred in connection with the administration of the estate or trust and which would not have been incurred if the property were not held in such estate or trust, and (2) deductions allowable under section 642(b) (concerning the personal exemption of an estate or non-grantor trust), section 651 (concerning the deduction for trusts distributing current income), and section 661 (concerning the deduction for trusts accumulating income). Accordingly, section 67(e) removes the deductions in section 67(e)(1) and (2) from the definition of itemized deductions under section 63(d), and thus from the definition of miscellaneous itemized deductions under

section 67(b), and treats them as deductions allowable in arriving at adjusted gross income under section 62(a). Section 67(e) further provides regulatory authority to make appropriate adjustments in the application of part I of subchapter J of chapter 1 of the Code to take into account the provisions of section 67.

On July 13, 2018, the Treasury Department and the IRS issued Notice 2018-61, 2018-31 I.R.B. 278, announcing that proposed regulations would be issued concerning the effect of section 67(g) on the deductibility of certain expenses described in section 67(b) and (e) incurred by estates and non-grantor trusts. The notice states that regulations would clarify that expenses described in section 67(e) remain deductible in determining the adjusted gross income of an estate or non-grantor trust during the taxable years in which section 67(g) applies.

III. *Section 642(h)*

Section 642(h) provides that if, on the termination of an estate or trust, the estate or trust has: (1) a net operating loss carryover under section 172 or a capital loss carryover under section 1212, or (2) for the last taxable year of the estate or trust, deductions (other than the deductions allowed under section 642(b) (relating to the personal exemption) or section 642(c) (relating to charitable contributions)) in excess of gross income for such year, then such carryover or such excess shall be allowed as a deduction, in accordance with the regulations prescribed by the Secretary of the Treasury or his delegate, to the beneficiaries succeeding to the property of the estate or trust.

Net operating loss and capital loss carryovers under section 642(h)(1) are used to compute adjusted gross income on the return of a beneficiary, formerly referred to as an above-the-line deduction. *See* §1.642(h)-1. The excess deduction under section 642(h)(2) is not, however, used to compute adjusted gross income on the return of a beneficiary. Instead, §1.642(h)-2(a) provides that the section 642(h)(2) excess deduction is "allowed only in computing taxable income and must be taken into account in computing the items of tax preference of beneficiaries; it is not allowed in computing adjusted gross income." As a result, under the existing regulations, excess deductions on termination of an estate or trust are treated as a single miscellaneous itemized deduction (section 642(h)(2) excess deduction) of the beneficiary subject to disallowance under section 67(g). *See also* sections 63(d) and 67(b).

The section 642(h)(2) excess deduction may be comprised of several types of deductions including: (1) those deductions allowable in arriving at adjusted gross income under sections 62 and 67(e); (2) itemized deductions under section 63(d) allowable in computing taxable income; and (3) miscellaneous itemized deductions currently disallowed under section 67(g). *See* section 67(b). Notice 2018-61 explained that the Treasury Department and the IRS were studying whether section 67(e) deductions, as well as other deductions not subject to the limitations imposed by sections 67(a) and (g) in the hands of the estate or trust, should continue to be treated as miscellaneous itemized deductions when included as a section 642(h)(2) excess deduction.

Notice 2018-61 requested comments regarding the effect of section 67(g) on the ability of the beneficiary to deduct amounts comprising the section 642(h)(2) excess deduction on the termination of an estate or trust considering section 642(h) and §1.642(h)-2(a) and expressed the intent to address this issue in regulations. The Treasury Department and the IRS requested comments regarding whether the separate deductions comprising the section 642(h)(2) excess deduction, such as section 67(e) deductions, should be analyzed separately when applying section 67.

The Treasury Department and the IRS received comments addressing issues concerning section 67(e), as well as excess deductions on termination of an estate or trust under section 642(h), as discussed in more detail in the Explanation of Provisions section of this preamble. All comments were considered and are available for public inspection. The Treasury Department and the IRS continue to study issues related to sections 67 and 642 that are beyond the scope of these proposed regulations and may discuss those comments in future guidance.

Explanation of Provisions

I. *Section 1.67-4*

Commenters agreed with the statements in Notice 2018-61 that deductions described in section 67(e)(1) and (2) are not miscellaneous itemized deductions subject to disallowance by section 67(g) and asked that the language in §1.67-4 be amended to clarify this position. This document contains proposed regulations amending §1.67-4 to clarify that section 67(g) does not deny an estate or non-grantor trust (including the S portion of an electing small business trust) a deduction for expenses described in section 67(e)(1) and (2) because such deductions are allowable in arriving at adjusted gross income and are not miscellaneous itemized deductions under section 67(b).

One commenter asked that the regulations address the treatment of expenses and deductions described in section 67(e)(1) and (2) in determining an estate or non-grantor trust's income for alternative minimum tax (AMT) purposes. The commenter requested that regulations provide that such expenses and deductions continue to be deductible for AMT purposes. The treatment of expenses and deductions described in section 67(e) for purposes of determining AMT is outside the scope of these proposed regulations concerning the effects of section 67(g); therefore, these proposed regulations do not address the AMT.

II. *Regulations Under Section 642(h)*

A. Character and Amount of the Excess Deductions

Commenters opined that the Treasury Department and the IRS have and should exercise their regulatory authority not to treat the section 642(h)(2) excess deduction as a single miscellaneous itemized deduction. Commenters noted that the regulations under §1.642(h)-2 were written before the concept of miscellaneous itemized deductions was added to the Code and need to be updated.

In response to the request for comments in Notice 2018-61 concerning analysis of the separate deductions that comprise the section 642(h)(2) excess deduction,

commenters stated that the Treasury Department and the IRS should provide regulations for the segregation of the section 642(h)(2) excess deduction into its components to determine the character, computation, and deductibility of costs. One commenter said that failure to provide for such segregation could result in either the prolonged administration of estates or trusts, or the sale of assets, to fully utilize deductible costs at the estate or trust level. Another commenter stated that the portion of the section 642(h)(2) excess deduction that qualifies as section 67(e)(1) expenses should remain deductible in arriving at a beneficiary's adjusted gross income and that the remaining section 642(h)(2) excess deduction should be treated as a single itemized deduction, which would avoid having to further separate out the individual costs comprising the excess deduction to determine deductibility at the beneficiary level. Other commenters proposed treating the section 642(h)(2) excess deduction as allowable in full in arriving at the beneficiary's adjusted gross income similar to the treatment of a section 67(e) deduction.

Another commenter requested more specific guidance on the character of the excess deductions. The commenter recommended that the fiduciary be required to separate deductions into at least three categories: (1) deductions allowed in arriving at adjusted gross income, (2) non-miscellaneous itemized deductions, and (3) miscellaneous itemized deductions. This commenter stated that the character of the deductions should not change when succeeded to by the beneficiaries on termination of the estate or trust. Further, the commenter suggested that regulations require that deductions subject to limitation when claimed by a beneficiary be separately identified (for example, the limitation on state and local property and income tax deductions under section 164(b)(6)). The commenter also requested guidance on how each item of deduction offsets items of income of the estate or trust in the final year of administration for purposes of determining the character of the excess deductions. The character of the excess deductions will vary based on how an executor or trustee allocates deductions against the income of the estate or trust. The same commenter suggested that the rules under §1.652(b)-3, which are used for determining the character of distributable net income to beneficiaries under sections 652 and 662, be used as a model to determine how deductions are allocated to offset income in the final year of administration of the estate or trust for purposes of determining the character of the section 642(h)(2) excess deduction.

The Treasury Department and the IRS adopt the more specific suggestion from commenters of preserving the tax character of the three categories of expenses, rather than the suggestion of grouping all non-section 67(e) expenses together, to allow for such expenses to be separately stated and to facilitate reporting to beneficiaries. Thus, under these proposed regulations, each deduction comprising the section 642(h)(2) excess deduction retains its separate character, specifically: as an amount allowed in arriving at adjusted gross income; a non-miscellaneous itemized deduction; or a miscellaneous itemized deduction. The character of these deductions does not change when succeeded to by a beneficiary on termination of the estate or trust. Further, these proposed regulations require that the fiduciary separately state (that is, separately identify) deductions that may be limited when claimed by the beneficiary as provided in the instructions to Form 1041, *U.S. Income Tax Return for Estates and Trusts* and the Schedule K-1 (Form 1041), *Beneficiary's Share of Income, Deductions, Credit, etc*.

The proposed regulations adopt the suggestion that the principles under §1.652(b)-3 be used to allocate each item of deduction among the classes of income in the year of termination for purposes of determining the character and amount of the excess deductions under section 642(h)(2). Section 1.652(b)-3(a) provides that deductions directly attributable to one class of income are allocated to that income. Any remaining deductions that are not directly attributable to a specific class of income, as well as any deductions that exceed the amount of directly attributable income, may be allocated to any item of income (including capital gains), but a portion must be allocated to tax-exempt income, if any. *See* §1.652(b)-3(b) and (d). The proposed regulations provide that the character and amount of each deduction remaining after application of §1.652(b)-3 comprises the excess deductions available to the beneficiaries succeeding to the property as provided under section 642(h)(2).

These proposed regulations incorporate a new example to illustrate the rule for determining the character of excess deductions in proposed §1.642(h)-2. The proposed regulations also update the current example in §1.642(h)-5 to account for changes in the Code since this example was last modified on June 16, 1965, in T.D. 6828, 1965-2 C.B. 264.

B. Allocation of the Excess Deduction Among Beneficiaries

One commenter requested guidance on allocating the excess deductions among multiple beneficiaries and suggested that the allocation could be made generally, in proportion to the entire amount of deductions, or specifically, based on the burden the beneficiary bears as to each deduction. The commenter noted, however, that a specific allocation may increase fiduciary reporting and IRS administrative burdens and may not be worth the added complexity.

Existing regulations under §1.642(h)-4 provide that carryovers and excess deductions to which section 642(h) applies are allocated among the beneficiaries succeeding to the property of an estate or trust proportionately according to the share of each in the burden of the loss or deduction. A person who qualifies as a beneficiary succeeding to the property of an estate or trust with respect to one amount and who does not qualify with respect to another amount is a beneficiary succeeding to the property of the estate or trust as to the amount with respect to which the beneficiary qualifies. These proposed regulations do not change the allocation method among beneficiaries set forth in §1.642(h)-4.

One commenter asked that the Treasury Department and the IRS address the treatment of suspended deductions on the termination of a trust, such as those under section 163(d) for investment interest, and asked that such suspended deductions be treated in the same manner as the excess deduction under section 642(h). While the Treasury Department and the IRS acknowledge the comment, addressing suspended deductions under section 163(d)

and other Code sections is beyond the scope of these proposed regulations.

Proposed Applicability Date

These proposed regulations apply to taxable years beginning after the date these regulations are published as final regulations in the **Federal Register**. However, estates, non-grantor trusts, and their beneficiaries may rely on these proposed regulations under section 67 for taxable years beginning after December 31, 2017, and on or before the date these regulations are published as final regulations in the **Federal Register**. Taxpayers may also rely on the proposed regulations under section 642(h) for taxable years of beneficiaries beginning after December 31, 2017, and on or before the date these regulations are published as final regulations in the **Federal Register** in which an estate or trust terminates.

One commenter asked that the Treasury Department and the IRS clarify that expenses incurred during an estate's fiscal year beginning before January 1, 2018, which properly are characterized as miscellaneous itemized deductions, remain deductible as such even if some of the costs were paid after January 1, 2018. Section 67(g) applies to taxable years beginning after December 31, 2017; therefore section 67(g) would not apply to an estate's or trust's taxable years beginning before that date.

Special Analyses

This regulation is not subject to review under section 6(b) of Executive Order 12866 pursuant to the Memorandum of Agreement (April 11, 2018) between the Treasury Department and the Office of Management and Budget regarding review of tax regulations. Therefore, a regulatory impact assessment is not required.

Pursuant to the Regulatory Flexibility Act (5 U.S.C. chapter 6), it is hereby certified that these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that the amount of time necessary to report the required information will be minimal in that it requires fiduciaries of estates and trusts to provide information already maintained and reported to the IRS on Form 1041, on the Schedule K-1 (Form 1041) issued to beneficiaries. Moreover, it should take an estate or trust no more than 2 hours to satisfy the information requirement in these regulations. Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small businesses.

Paperwork Reduction Act

The collection of information related to these proposed regulations under section 642(h) is reported on Schedule K-1 (Form 1041), Beneficiary's Share of Income, Deductions, Credits, etc., and has been reviewed in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) and approved by the Office of Management and Budget under control number 1545-0092. Comments concerning the collection of information and the accuracy of estimated average annual burden and suggestions for reducing this burden should be sent to the Office of Management and Budget, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the Internal Revenue Service, IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP, Washington, DC 20224. Comments on the burden associated with this collection of information must be received by July 10, 2020.

The collection of information in these proposed regulations is in proposed §1.642(h)-2(b)(1). The IRS requires this information to ensure that excess deductions on an estate's or trust's termination that are subject to additional applicable limitations retain their character when taken into account by beneficiaries on their returns. The respondents will be estates, trusts, and their fiduciaries.

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.

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.

Comments and Requests for Public Hearing

Before these proposed amendments to the regulations are adopted as final regulations, consideration will be given to comments that are submitted timely to the IRS as prescribed in the preamble under the "**ADDRESSES**" section. The Treasury Department and the IRS request comments on all aspects of the proposed regulations. Any electronic comments submitted, and to the extent practicable any paper comments submitted, will be made available at *www.regulations.gov* or upon request.

A public hearing will be scheduled if requested in writing by any person who timely submits electronic or written comments. Requests for a public hearing are also encouraged to be made electronically. If a public hearing is scheduled, notice of the date and time for the public hearing will be published in the **Federal Register**. Announcement 2020-4, 2020-17 IRB 1, provides that until further notice, public hearings conducted by the IRS will be held telephonically. Any telephonic hearing will be made accessible to people with disabilities.

Drafting Information

The principal author of these proposed regulations is Margaret Burow of the Office of Associate Chief Counsel (Passthroughs and Special Industries). Other personnel from the Treasury Department and the IRS, however, participated in their development.

Statement of Availability of IRS Documents

The IRS notice cited in this document is published in the Internal Revenue Bulletin and available from the Superintendent of Documents, U.S. Government Publishing Office, Washington, DC 20402, or by visiting the IRS website at *http://www.irs.gov*.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

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 is amended by adding an entry for §1.67-4 and an entry for §§1.642(h)-2 and 1.642(h)-5 in numerical order to read in part as follows:

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

Section 1.67-4 also issued under 26 U.S.C. 67(e).

* * * * *

Sections 1.642(h)-2 and 1.642(h)-5 also issued under 26 U.S.C. 642(h).

* * * * *

Par. 2. Section 1.67-4 is amended by revising paragraph (a) and the heading of paragraph (d) and adding a sentence at the end of paragraph (d) to read as follows:

§1.67-4. Costs paid or incurred by estates or non-grantor trusts.

(a) *In general*—(1) *Section 67(e) deductions*. (i) An estate or trust (including the S portion of an electing small business trust) not described in §1.67-2T(g)(1)(i) (a non-grantor trust) shall compute its adjusted gross income in the same manner as an individual, except that the following deductions (*Section 67(e) deductions*) are allowed in arriving at adjusted gross income:

(A) Costs that are paid or incurred in connection with the administration of the estate or trust, which would not have been incurred if the property were not held in such estate or trust; and

(B) Deductions allowable under section 642(b) (relating to the personal exemption) and sections 651 and 661 (relating to distributions).

(ii) Section 67(e) deductions are not itemized deductions under section 63(d) and are not miscellaneous itemized deductions under section 67(b). Therefore, section 67(e) deductions are not disallowed under section 67(g).

(2) *Deductions subject to 2-percent floor*. A cost is not a section 67(e) deduction and thus is subject to both the 2-percent floor in section 67(a) and section 67(g) to the extent that it is included in the definition of miscellaneous itemized deductions under section 67(b), is incurred by an estate or non-grantor trust (including the S portion of an electing small business trust), and commonly or customarily would be incurred by a hypothetical individual holding the same property.

* * * * *

(d) *Applicability date*. * * * Paragraph (a) of this section applies to taxable years beginning after **[***date these regulations are published as final in the Federal Register***]**.

Par. 3. Section 1.642(h)-2 is amended by:

1. Revising paragraph (a).

2. Redesignating paragraph (b) as paragraph (d) and adding a heading for newly redesignated paragraph (d).

3. Redesignating paragraph (c) as paragraph (e) and adding a heading for newly redesignated paragraph (e).

4. Adding new paragraphs (b), (c), and (f).

The revisions and additions read as follows:

§1.642(h)-2 Excess deductions on termination of an estate or trust.

(a) *In general*. If, on the termination of an estate or trust, the estate or trust has for its last taxable year deductions (other than the deductions allowed under section 642(b) (relating to the personal exemption) or section 642(c) (relating to charitable contributions)) in excess of gross income, the excess deductions are allowed under section 642(h)(2) as items of deduction to the beneficiaries succeeding to the property of the estate or trust.

(b) *Character and amount of excess deductions*—(1) *Character*. The character and amount of the excess deductions on termination of an estate or trust will be determined as provided in this paragraph (b). Each deduction comprising the excess deductions under section 642(h)(2) retains, in the hands of the beneficiary, its character (specifically, as allowable in arriving at adjusted gross income, as a non-miscellaneous itemized deduction, or as a miscellaneous itemized deduction) while in the estate or trust. An item of deduction succeeded to by a beneficiary remains subject to any additional applicable limitation under the Code and must be separately stated if it could be so limited, as provided in the instructions to Form 1041, *U.S. Income Tax Return for Estates and Trusts* and the Schedule K-1 (Form 1041), *Beneficiary's Share of Income, Deductions, Credit, etc.*, or successor forms.

(2) *Amount*. The amount of the excess deductions in the final year is determined as follows:

(i) Each deduction directly attributable to a class of income is allocated in accordance with the provisions in §1.652(b)-3(a);

(ii) To the extent of any remaining income after application of paragraph (b)(2)(i) of this section, deductions are allocated in accordance with the provisions in §1.652(b)-3(b) and (d); and

(iii) Deductions remaining after the application of paragraph (b)(2)(i) and (ii) of this section comprise the excess deductions on termination of the estate or trust. These deductions are allocated to the beneficiaries succeeding to the property of the estate of or trust in accordance with §1.642(h)-4.

(c) *Year of termination*—(1) *In general*. The deductions provided for in paragraph (a) of this section are allowable only in the taxable year of the beneficiary in which or with which the estate or trust terminates, whether the year of termination of the estate or trust is of normal duration or is a short taxable year.

(2) *Example*. Assume that a trust distributes all its assets to B and terminates on December 31, Year X. As of that date, it has excess deductions of $18,000, all characterized as allowable in arriving at adjusted gross income under section 67(e). B, who reports on the calendar year basis, could claim the $18,000 as a deduction allowable in arriving at B's adjusted gross income for Year X. However, if the deduction (when added to B's other deductions) exceeds B's gross income, the excess may not be carried over to any year subsequent to Year X.

(d) *Net operating loss carryovers*. * * *

(e) *Items included in net operating loss or capital loss carryovers*. * * *

(f) *Applicability date*. Paragraphs (a) and (b) of this section apply to taxable years beginning after **[***date these regulations are published as final in the* ***Federal Register*****]**.

Par. 4. Section 1.642(h)-5 is revised to read as follows:

§1.642(h)-5 Examples.

The following examples illustrate the application of section 642(h).

(a) *Example 1. Computations under section 642(h) when an estate has a net operating loss*—(1) *Facts*. On January 31, 2020, A dies leaving a will that provides for the distribution of all of A's estate equally to B and an existing trust for C. The period of administration of the estate terminates on December 31, 2020, at which time all the property of the estate is distributed to B and the trust. For tax purposes, B and the trust report income on a calendar year basis. During the period of administration, the estate has the following items of income and deductions:

Table 1 to Paragraph (a)(1)

Income	
Taxable interest	$2,500
Business income	3,000
Total income	5,500

Table 2 to Paragraph (a)(1)

Deductions	
Business expenses (including administrative expense allocable to business income)	5,000
Administrative expenses not allocable to business income that would not have been incurred if property had not been held in a trust or estate (section 67(e) deductions)	9,800
Total deductions	14,800

(2) *Computation of net operating loss*. (i) Under section 642(h)(1), B and the trust are each allocated $1,000 of the $2,000 unused net operating loss carryover of the terminated estate in the taxable year, with the allowance of any net operating loss and loss carryover to B and the trust determined under section 172. The amount of the net operating loss carryover is computed as follows:

Table 3 to Paragraph (a)(2)(i)

Gross income	$5,500
Total deductions	14,800
Less adjustment under section 172(d)(4) (allowable non-business expenses ($9,800) limited to non-business income ($2,500))	7,300
Deductions as adjusted	7,500
Net operating loss	2,000

(ii) Neither B nor the trust can carry back any of the net operating loss of A's estate made available to them under section 642(h)(1).

(3) *Section 642(h)(2) excess deductions*. The $7,300 of deductions not taken into account in determining the net operating loss of the estate are excess deductions on termination of the estate under section 642(h)(2). Under §1.642(h)-2(b)(1), such deductions retain their character as section 67(e) deductions. Under §1.642(h)-4, B and the trust each are allocated $3,650 of excess deductions based on B's and the trust's respective shares of the burden of each cost.

(4) *Consequences for C*. The net operating loss carryovers and excess deductions are not allowable directly to C, the trust beneficiary. To the extent the distributable net income of the trust is reduced by the carryovers and excess deductions, however, C may receive an indirect benefit from the carryovers and excess deductions.

(b) *Example 2. Computations under section 642(h)(2)*—(1) *Facts*. D dies in 2019 leaving an estate of which the residuary legatees are E (75%) and F (25%). The estate's income and deductions in its final year are as follows:

Table 4 to Paragraph (b)(1)

Income	
Dividends	$3,000
Taxable Interest	.500
Rents	2,000
Capital Gain	1,000
Total Income	6,500

Table 5 to Paragraph (b)(1)

Deductions	
Section 67(e) deductions:	
Probate fees	1,500
Estate tax preparation fees	8,000
Legal fees	4,500
Total Section 67(e) deductions	14,000
Itemized deductions:	
Real estate taxes on rental property	3,500
Total deductions.	17,500

(2) *Determination of character*. Pursuant to §1.642(h)-2(b)(2), the character and amount of the excess deductions is determined by allocating the deductions among the estate's items of income as provided under §1.652(b)-3. Under §1.652(b)-3(a), $2,000 of real estate taxes is allocated to the $2,000 of rental income. In the exercise of the executor's discretion pursuant to §1.652(b)-3(b) and (d), D's executor allocates $4,500 of section 67(e) deductions to the remaining $4,500 of income. As a result, the excess deductions on termination of the estate are $11,000, consisting of $9,500 of section 67(e) deductions and $1,500 of itemized deductions.

(3) *Allocations among beneficiaries*. Pursuant to §1.642(h)-4, the excess deductions are allocated in accordance with E's (75 percent) and F's (25 percent) interests in the residuary estate. E's share of the excess deductions is $8,250, consisting of $7,125 of section 67(e) deductions and $1,125 of real estate taxes. F's share of the excess deductions is $2,750, consisting of $2,375 of section 67(e) deductions and $375 of real estate taxes. The real estate taxes on rental property must be separately stated as provided in §1.642(h)-2(b)(1).

(c) *Applicability date*. This section is applicable to taxable years beginning after [*date these regulations are published as final in the* ***Federal Register***].

Sunita Lough,
Deputy Commissioner for Services and Enforcement.

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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[1]

Bulletin 2020–22

AOD:

2020-1, 2020-12 I.R.B. *521*
2020-2, 2020-14 I.R.B. *558*
2020-3, 2020-17 I.R.B. *663*

Announcements:

2020-1, 2020-5 I.R.B. *552*
2020-2, 2020-15 I.R.B. *609*
2020-3, 2020-15 I.R.B. *655*
2020-4, 2020-17 I.R.B. *667*
2020-5, 2020-19 I.R.B. *796*

Notices:

2020-1, 2020-2 I.R.B. *290*
2020-2, 2020-3 I.R.B. *327*
2020-3, 2020-3 I.R.B. *330*
2020-4, 2020-4 I.R.B. *380*
2020-5, 2020-4 I.R.B. *380*
2020-6, 2020-7 I.R.B. *411*
2020-7, 2020-7 I.R.B. *411*
2020-8, 2020-7 I.R.B. *415*
2020-9, 2020-7 I.R.B. *417*
2020-10, 2020-10 I.R.B. *456*
2020-11, 2020-11 I.R.B. *492*
2020-12, 2020-11 I.R.B. *495*
2020-13, 2020-11 I.R.B. *502*
2020-14, 2020-13 I.R.B. *555*
2020-15, 2020-14 I.R.B. *559*
2020-16, 2020-14 I.R.B. *559*
2020-17, 2020-15 I.R.B. *590*
2020-18, 2020-15 I.R.B. *590*
2020-19, 2020-15 I.R.B. *591*
2020-20, 2020-16 I.R.B. *660*
2020-21, 2020-16 I.R.B. *660*
2020-22, 2020-17 I.R.B. *664*
2020-23, 2020-18 I.R.B. *742*
2020-26, 2020-18 I.R.B. *744*
2020-27, 2020-19 I.R.B. *778*
2020-28, 2020-19 I.R.B. *781*
2020-30, 2020-19 I.R.B. *781*
2020-31, 2020-19 I.R.B. *783*
2020-32, 2020-21 I.R.B. *837*
2020-34, 2020-21 I.R.B. *838*
2020-36, 2020-21 I.R.B. *840*
2020-25, 2020-22 I.R.B. *863*
2020-29, 2020-22 I.R.B. *864*
2020-33, 2020-22 I.R.B. *868*

Proposed Regulations:

REG-107431-19, 2020-3 I.R.B. *332*
REG-122180-18, 2020-3 I.R.B. *342*
REG-100956-19, 2020-4 I.R.B. *383*

Proposed Regulations:—Continued

REG-125710-18, 2020-5 I.R.B. *554*
REG-132741-17, 2020-10 I.R.B. *458*
REG-100814-19, 2020-12 I.R.B. *542*
REG-132529-17, 2020-12 I.R.B. *667*
REG-106013-19, 2020-18 I.R.B. *757*
REG-117138-17, 2020-19 I.R.B. *796*
REG-106864-18, 2020-20 I.R.B. *805*
REG-113295-18, 2020-22 I.R.B. *875*

Revenue Procedures:

2020-1, 2020-01 I.R.B. *1*
2020-2, 2020-01 I.R.B. *107*
2020-3, 2020-01 I.R.B. *131*
2020-4, 2020-01 I.R.B. *148*
2020-5, 2020-01 I.R.B. *241*
2020-7, 2020-01 I.R.B. *281*
2020-9, 2020-02 I.R.B. *294*
2020-10, 2020-02 I.R.B. *295*
2020-11, 2020-06 I.R.B. *406*
2020-8, 2020-08 I.R.B. *447*
2020-12, 2020-11 I.R.B. *511*
2020-13, 2020-11 I.R.B. *515*
2020-17, 2020-12 I.R.B. *539*
2020-18, 2020-15 I.R.B. *592*
2020-14, 2020-16 I.R.B. *661*
2020-22, 2020-18 I.R.B. *745*
2020-23, 2020-18 I.R.B. *749*
2020-24, 2020-18 I.R.B. *750*
2020-26, 2020-18 I.R.B. *753*
2020-25, 2020-19 I.R.B. *785*
2020-28, 2020-19 I.R.B. *792*
2020-20, 2020-20 I.R.B. *801*
2020-27, 2020-20 I.R.B. *803*
2020-29, 2020-21 I.R.B. *859*
2020-19, 2020-22 I.R.B. *871*
2020-21, 2020-22 I.R.B. *872*
2020-30, 2020-22 I.R.B. *873*

Revenue Rulings:

2020-1, 2020-3 I.R.B. *296*
2020-2, 2020-3 I.R.B. *298*
2020-3, 2020-3 I.R.B. *409*
2020-4, 2020-4 I.R.B. *444*
2020-5, 2020-5 I.R.B. *454*
2020-6, 2020-11 I.R.B. *490*
2020-7, 2020-12 I.R.B. *522*
2020-9, 2020-15 I.R.B. *563*
2020-10, 2020-15 I.R.B. *565*
2020-8, 2020-19 I.R.B. *775*
2020-11, 2020-19 I.R.B. *776*

Treasury Decisions:

9886, 2020-2 I.R.B. *285*
9887, 2020-3 I.R.B. *302*
9888, 2020-3 I.R.B. *306*

Treasury Decisions:— Continued

9891, 2020-8 I.R.B. *419*
9892, 2020-8 I.R.B. *439*
9893, 2020-9 I.R.B. *449*
9895, 2020-15 I.R.B. *565*
9896, 2020-18 I.R.B. *681*

[1] A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2018–27 through 2018–52 is in Internal Revenue Bulletin 2018–52, dated December 27, 2018.

Finding List of Current Actions on Previously Published Items[1]

Bulletin 2020–22

[1] A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2018–27 through 2018–52 is in Internal Revenue Bulletin 2018–52, dated December 27, 2018.

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