Internal Revenue
bulletin

Bulletin No. 2005-41
October 11, 2005

HIGHLIGHTS OF THIS ISSUE

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

INCOME TAX

Rev. Rul. 2005–65, page 684.

Section 355(e). Guidance is provided on whether, under the described facts, an acquisition and a distribution are part of a plan under section 355(e) of the Code and section 1.355–7(b) of the regulations.

Rev. Rul. 2005–66, page 686.

Federal rates; adjusted federal rates; adjusted federal long-term rate and the long-term exempt rate. For purposes of sections 382, 642, 1274, 1288, and other sections of the Code, tables set forth the rates for October 2005.

T.D. 9224, page 688.

Final regulations under section 6654 of the Code provide information for making payments of estimated income tax by individuals. The regulations incorporate changes made by the Tax Reform Act of 1984 and are necessary to update, clarify, and reorganize the rules and procedures under section 6654. The regulations do not impose any new requirements for taxpayers.

Notice 2005–70, page 694.

Section 362(e). This notice provides guidance on how to make an election under section 362(e)(2)(C) of the Code.

EMPLOYMENT TAX

REG–104143–05, page 708.

Proposed regulations under section 3121 of the Code amend existing regulations as to the dollar threshold amounts and time periods used to determine whether payments for 1) domestic service in a private home of the employer, 2) agricultural labor, 3) service not in the course of the employer's trade or business, and 4) services provided by home workers described in section 3121(d)(3)(C) are wages subject to Federal Insurance Contributions Act (FICA) taxes.

EXCISE TAX

REG–138647–04, page 697.

Proposed regulations under section 4980G of the Code provide guidance regarding employer comparable contributions to the Health Savings Accounts (HSAs) of employees. The regulations set forth the rules for determining the applicability of the comparability rules and for determining whether an employer's contributions satisfy the comparability rules.

TAX CONVENTIONS

Announcement 2005–72, page 692.

U.S.-Mexico MAP Agreement regarding eligibility of fiscally transparent entities to benefits. A copy of the news release issued by the Director, International (U.S. Competent Authority), on September 19, 2005 (IR–2005–17), is set forth.

(Continued on the next page)

Finding Lists begin on page ii.

Department of the Treasury
Internal Revenue Service

ADMINISTRATIVE

Rev. Proc. 2005–68, page 694.

This procedure provides guidelines for requesting expedited processing of letter ruling requests for certain reorganizations and for distributions under section 355 of the Code, and clarifies the requirement that a "significant issue" be present before the Service will rule on certain transactions. Rev. Procs. 2005–1 and 2005–3 amplified.

Announcement 2005–71, page 714.

Revised optional standard mileage rates for 2005. This announcement advises taxpayers that the Service is revising the optional standard mileage rates for business, medical, and moving expenses. Effective September 1, 2005, the business standard mileage rate is 48.5 cents per mile and the standard mileage rate for medical and moving expenses is 22 cents per mile. Rev. Proc. 2004–64 modified.

Announcement 2005–73, page 715.

This announcement contains updates and corrections to Publication 1187, *Specifications for Filing Form 1042–S, Foreign Person's U.S. Source Income Subject to Withholding, Electronically or Magnetically*.

The IRS Mission

Provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax 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 and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents are compiled semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

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.

For sale by the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402.

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

Section 42.—Low-Income Housing Credit

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 2005. See Rev. Rul. 2005-66, page 686.

Section 280G.—Golden Parachute Payments

Federal short-term, mid-term, and long-term rates are set forth for the month of October 2005. See Rev. Rul. 2005-66, page 686.

Section 355.—Distribution of Stock and Securities of a Controlled Corporation

26 CFR 1.355–7: Recognition of Gain on Certain Distributions of Stock or Securities in Connection with an Acquisition.

Section 355(e). Guidance is provided on whether, under the described facts, an acquisition and a distribution are part of a plan under section 355(e) of the Code and section 1.355–7(b) of the regulations.

Rev. Rul. 2005–65

ISSUE

Under the facts described below, is a distribution of a controlled corporation by a distributing corporation part of a plan pursuant to which one or more persons acquire stock in the distributing corporation under § 355(e) of the Internal Revenue Code and § 1.355–7 of the Income Tax Regulations?

FACTS

Distributing is a publicly traded corporation that conducts a pharmaceuticals business. Controlled, a wholly owned subsidiary of Distributing, conducts a cosmetics business. Distributing does all of the borrowing for both Distributing and Controlled and makes all decisions regarding the allocation of capital spending between the pharmaceuticals and cosmetics businesses. Because Distributing's capital spending in recent years for both the pharmaceuticals and cosmetics businesses has outpaced internally generated cash flow from the businesses, it has had to limit total expenditures to maintain its credit ratings. Although the decisions reached by Distributing's senior management regarding the allocation of capital spending usually favor the pharmaceuticals business due to its higher rate of growth and profit margin, the competition for capital prevents both businesses from consistently pursuing development strategies that the management of each business believes are appropriate.

To eliminate this competition for capital, and in light of the unavailability of nontaxable alternatives, Distributing decides and publicly announces that it intends to distribute all the stock of Controlled *pro rata* to Distributing's shareholders. It is expected that both businesses will benefit in a real and substantial way from the distribution. This business purpose is a corporate business purpose (within the meaning of § 1.355–2(b)). The distribution is substantially motivated by this business purpose, and not by a business purpose to facilitate an acquisition.

After the announcement but before the distribution, X, a widely held corporation that is engaged in the pharmaceuticals business, and Distributing begin discussions regarding an acquisition. There were no discussions between Distributing or Controlled and X or its shareholders regarding an acquisition or a distribution before the announcement. In addition, Distributing would have been able to continue the successful operation of its pharmaceuticals business without combining with X. During its negotiations with Distributing, X indicates that it favors the distribution. X merges into Distributing before the distribution but nothing in the merger agreement requires the distribution.

As a result of the merger, X's former shareholders receive 55 percent of Distributing's stock. In addition, X's chairman of the board and chief executive officer become the chairman of the board and chief executive officer, respectively, of Distributing. Six months after the merger, Distributing distributes the stock of Controlled *pro rata* in a distribution to which § 355 applies and to which § 355(d) does not apply. At the time of the distribution, the distribution continues to be substantially motivated by the business purpose of eliminating the competition for capital between the pharmaceuticals and cosmetics businesses.

LAW

Section 355(c) generally provides that no gain or loss is recognized to the distributing corporation on a distribution of stock in a controlled corporation to which § 355 (or so much of § 356 as relates to § 355) applies and which is not in pursuance of a plan of reorganization. Section 355(e) generally denies nonrecognition treatment under § 355(c) if the distribution is part of a plan (or series of related transactions) (a plan) pursuant to which one or more persons acquire directly or indirectly stock representing a 50-percent or greater interest in the distributing corporation or any controlled corporation.

Section 1.355–7(b)(1) provides that whether a distribution and an acquisition are part of a plan is determined based on all the facts and circumstances, including those set forth in § 1.355–7(b)(3) (plan factors) and (4) (non-plan factors). The weight to be given each of the facts and circumstances depends on the particular case. The determination does not depend on the relative number of plan factors compared to the number of non-plan factors that are present.

Section 1.355–7(b)(3)(iii) provides that, in the case of an acquisition (other than involving a public offering) before a distribution, if at some time during the two-year period ending on the date of the acquisition there were discussions by Distributing or Controlled with the acquirer regarding a distribution, such discussions tend to show that the distribution and the acquisition are part of a plan. The weight to be accorded this fact depends on the nature, extent, and timing of the discussions. In addition, the fact that the acquirer intends to cause a distribution and, immediately after the acquisition, can meaningfully participate in the decision regarding whether to make a distribution, tends to show that the distribution and the acquisition are part of a plan.

Section 1.355–7(b)(4)(iii) provides that, in the case of an acquisition (other than involving a public offering) before a distribution, the absence of discussions by Distributing or Controlled with the acquirer regarding a distribution during the two-year period ending on the date of the earlier to occur of the acquisition or the first public announcement regarding the distribution tends to show that the distribution and the acquisition are not part of a plan. However, this factor does not apply to an acquisition where the acquirer intends to cause a distribution and, immediately after the acquisition, can meaningfully participate in the decision regarding whether to make a distribution.

Section 1.355–7(b)(4)(v) provides that the fact that the distribution was motivated in whole or substantial part by a corporate business purpose (within the meaning of § 1.355–2(b)) other than a business purpose to facilitate the acquisition or a similar acquisition tends to show that the distribution and the acquisition are not part of a plan.

Section 1.355–7(b)(4)(vi) provides that the fact that the distribution would have occurred at approximately the same time and in similar form regardless of the acquisition or a similar acquisition tends to show that the distribution and the acquisition are not part of a plan.

Section 1.355–7(h)(6) provides that discussions with the acquirer generally include discussions with persons with the implicit permission of the acquirer.

Section 1.355–7(h)(9) provides that a corporation is treated as having the implicit permission of its shareholders when it engages in discussions.

ANALYSIS

Whether the X shareholders' acquisition of Distributing stock and Distributing's distribution of Controlled are part of a plan depends on all the facts and circumstances, including those described in § 1.355–7(b). The fact that Distributing discussed the distribution with X during the two-year period ending on the date of the acquisition tends to show that the distribution and the acquisition are part of a plan. *See* § 1.355–7(b)(3)(iii). In addition, X's shareholders may constitute acquirers who intend to cause a distribution and who, immediately after the acquisition, can meaningfully participate (through X's chairman of the board and chief executive officer who become D's chairman of the board and chief executive officer) in the decision regarding whether to distribute Controlled. *See id*. However, the fact that Distributing publicly announced the distribution before discussions with X regarding both an acquisition and a distribution began suggests that the plan factor in § 1.355–7(b)(3)(iii) should be accorded less weight than it would have been accorded had there been such discussions before the public announcement.

With respect to those factors that tend to show that the distribution and the acquisition are not part of a plan, the absence of discussions by Distributing or Controlled with X or its shareholders during the two-year period ending on the date of the public announcement regarding the distribution would tend to show that the distribution and the acquisition are not part of a plan only if X's shareholders are not acquirers who intend to cause a distribution and who, immediately after the acquisition, can meaningfully participate in the decision regarding whether to distribute Controlled. *See* § 1.355–7(b)(4)(iii). Because X's chairman of the board and chief executive officer become the chairman and chief executive officer, respectively, of Distributing, X's shareholders may have the ability to meaningfully participate in the decision whether to distribute Controlled. Therefore, the absence of discussions by Distributing or Controlled with X or its shareholders during the two-year period ending on the date of the public announcement regarding the distribution may not tend to show that the distribution and the acquisition are not part of a plan.

Nonetheless, the fact that the distribution was substantially motivated by a corporate business purpose (within the meaning of § 1.355–2(b)) other than a business purpose to facilitate the acquisition or a similar acquisition, and the fact that the distribution would have occurred at approximately the same time and in similar form regardless of the acquisition or a similar acquisition, tend to show that the distribution and the acquisition are not part of a plan. *See* § 1.355–7(b)(4)(v), (vi). The fact that the public announcement of the distribution preceded discussions by Distributing or Controlled with X or its shareholders, and the fact that Distributing's business would have continued to operate successfully even if the merger had not occurred, evidence that the distribution originally was not substantially motivated by a business purpose to facilitate the acquisition or a similar acquisition. Moreover, after the merger, Distributing continued to be substantially motivated by the same corporate business purpose (within the meaning of § 1.355–2(b)) other than a business purpose to facilitate the acquisition or a similar acquisition (§ 1.355–7(b)(4)(v)). In addition, the fact that Distributing decided to distribute Controlled and announced that decision before it began discussions with X regarding the combination suggests that the distribution would have occurred at approximately the same time and in similar form regardless of Distributing's combination with X and the corresponding acquisition of Distributing stock by the X shareholders.

Considering all the facts and circumstances, particularly the fact that the distribution was motivated by a corporate business purpose (within the meaning of § 1.355–2(b)) other than a business purpose to facilitate the acquisition or a similar acquisition, and the fact that the distribution would have occurred at approximately the same time and in similar form regardless of the acquisition or a similar acquisition, the acquisition and distribution are not part of a plan under § 355(e) and § 1.355–7(b).

HOLDING

Under the facts described above, the acquisition and the distribution are not part of a plan under § 355(e) and § 1.355–7(b).

DRAFTING INFORMATION

The principal author of this revenue ruling is Ross Poulsen of the Office of Associate Chief Counsel (Corporate). For further information regarding this revenue ruling, contact Mr. Poulsen at (202) 622–7770 (not a toll-free call).

Section 382.—Limitation on Net Operating Loss Carryforwards and Certain Built-In Losses Following Ownership Change

The adjusted applicable federal long-term rate is set forth for the month of October 2005. See Rev. Rul. 2005-66, page 686.

Section 412.—Minimum Funding Standards

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 2005. See Rev. Rul. 2005-66, page 686.

Section 467.—Certain Payments for the Use of Property or Services

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 2005. See Rev. Rul. 2005-66, page 686.

Section 468.—Special Rules for Mining and Solid Waste Reclamation and Closing Costs

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 2005. See Rev. Rul. 2005-66, page 686.

Section 482.—Allocation of Income and Deductions Among Taxpayers

Federal short-term, mid-term, and long-term rates are set forth for the month of October 2005. See Rev. Rul. 2005-66, page 686.

Section 483.—Interest on Certain Deferred Payments

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 2005. See Rev. Rul. 2005-66, page 686.

Section 642.—Special Rules for Credits and Deductions

Federal short-term, mid-term, and long-term rates are set forth for the month of October 2005. See Rev. Rul. 2005-66, page 686.

Section 807.—Rules for Certain Reserves

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 2005. See Rev. Rul. 2005-66, page 686.

Section 846.—Discounted Unpaid Losses Defined

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 2005. See Rev. Rul. 2005-66, page 686.

Section 1274.—Determination of Issue Price in the Case of Certain Debt Instruments Issued for Property

(Also Sections 42, 280G, 382, 412, 467, 468, 482, 483, 642, 807, 846, 1288, 7520, 7872.)

Federal rates; adjusted federal rates; adjusted federal long-term rate and the long-term exempt rate. For purposes of sections 382, 642, 1274, 1288, and other sections of the Code, tables set forth the rates for October 2005.

Rev. Rul. 2005–66

This revenue ruling provides various prescribed rates for federal income tax purposes for October 2005 (the current month). Table 1 contains the short-term, mid-term, and long-term applicable federal rates (AFR) for the current month for purposes of section 1274(d) of the Internal Revenue Code. Table 2 contains the short-term, mid-term, and long-term adjusted applicable federal rates (adjusted AFR) for the current month for purposes of section 1288(b). Table 3 sets forth the adjusted federal long-term rate and the long-term tax-exempt rate described in section 382(f). Table 4 contains the appropriate percentages for determining the low-income housing credit described in section 42(b)(2) for buildings placed in service during the current month. Finally, Table 5 contains the federal rate for determining the present value of an annuity, an interest for life or for a term of years, or a remainder or a reversionary interest for purposes of section 7520.

REV. RUL. 2005–66 TABLE 1

Applicable Federal Rates (AFR) for October 2005

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-term				
AFR	3.89%	3.85%	3.83%	3.82%
110% AFR	4.28%	4.24%	4.22%	4.20%
120% AFR	4.67%	4.62%	4.59%	4.58%
130% AFR	5.07%	5.01%	4.98%	4.96%
Mid-term				
AFR	4.08%	4.04%	4.02%	4.01%
110% AFR	4.49%	4.44%	4.42%	4.40%
120% AFR	4.91%	4.85%	4.82%	4.80%
130% AFR	5.32%	5.25%	5.22%	5.19%
150% AFR	6.15%	6.06%	6.01%	5.98%
175% AFR	7.19%	7.07%	7.01%	6.97%
Long-term				
AFR	4.40%	4.35%	4.33%	4.31%
110% AFR	4.85%	4.79%	4.76%	4.74%
120% AFR	5.29%	5.22%	5.19%	5.16%
130% AFR	5.74%	5.66%	5.62%	5.59%

REV. RUL. 2005–66 TABLE 2

Adjusted AFR for October 2005

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-term adjusted AFR	2.83%	2.81%	2.80%	2.79%
Mid-term adjusted AFR	3.27%	3.24%	3.23%	3.22%
Long-term adjusted AFR	4.14%	4.10%	4.08%	4.07%

REV. RUL. 2005–66 TABLE 3

Rates Under Section 382 for October 2005

Adjusted federal long-term rate for the current month	4.14%
Long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months.)	4.24%

REV. RUL. 2005–66 TABLE 4

Appropriate Percentages Under Section 42(b)(2) for October 2005

Appropriate percentage for the 70% present value low-income housing credit	7.98%
Appropriate percentage for the 30% present value low-income housing credit	3.42%

REV. RUL. 2005–66 TABLE 5

Rate Under Section 7520 for October 2005

Applicable federal rate for determining the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest	5.0%

Section 1288.—Treatment of Original Issue Discount on Tax-Exempt Obligations

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 2005. See Rev. Rul. 2005-66, page 686.

Section 6654.—Failure by Individual to Pay Estimated Income Tax

26 CFR 1.6654–2: Exceptions to imposition of the addition to the tax in the case of individuals.

T.D. 9224

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

Updating Estimated Income Tax Regulations Under Section 6654

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to certain changes made to the law by the Tax Reform Act of 1984. These final regulations are necessary to update, clarify, and reorganize the rules and procedures for making payments of estimated income tax by individuals. These final regulations do not impose any new requirements for taxpayers.

DATES: *Effective Date*: These final regulations are effective September 2, 2005.

FOR FURTHER INFORMATION CONTACT: Tatiana Belenkaya of the Office of Associate Chief Counsel (Procedure and Administration), (202) 622–4910 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains amendments to 26 CFR part 1. Section 412 of the Tax Reform Act of 1984, Public Law 98–369 (98 Stat. 792), repealed section 6015 of the Internal Revenue Code (Code), which required individuals to file declarations of estimated income tax. Public Law 98–369 (98 Stat. 792) is effective for taxable years beginning after December 31, 1984; however, individual taxpayers still must pay estimated tax in quarterly installments under section 6654 of the Code.

Explanation of Provisions

In general, section 6654(a) of the Code provides that in the case of any underpayment of estimated tax by an individual, there shall be added to the tax under chapter 1 and the tax under chapter 2 for the taxable year an amount determined by applying (1) the underpayment rate established under section 6621, (2) to the amount of the underpayment, (3) for the period of the underpayment. Section 6654(m) authorizes the Secretary to prescribe such regulations as may be necessary to carry out the purposes of section 6654.

Prior to its repeal in 1984, section 6015 of the Code, and §§1.6015(a)–1 through 1.6015(j)–1 of the Income Tax Regulations, provided rules for making declarations of estimated income tax by individuals. Section 6015 of the Code was repealed for taxable years beginning after December 31, 1984. The repeal of section 6015 rendered §§1.6015(a)–1 through 1.6015(j)–1 obsolete, except to the extent that portions of these sections provide guidance still relevant to the payment of estimated tax under section 6654.

These final regulations remove §§1.6015(a)–1 through 1.6015(j)–1, revise §§1.6654–2 and 1.6654–3, and add §§1.6654–5 and 1.6654–6. Removing the obsolete declaration of estimated income tax regulations and revising the current estimated income tax regulations will clarify the estimated income tax regulations under section 6654 of the Code. Removal of §§1.6015(a)–1 through 1.6015(j)–1 also alleviates any confusion under the current section 6015 regulations, which address relief from joint and several liability for an individual who has made a joint return. Adding §§1.6654–5 and 1.6654–6 will provide additional instructions for determining estimated tax payments and additional guidance for nonresident alien individuals required to make estimated tax payments.

Special Analyses

Because these regulations are interpretative and generally re-codify, under an existing statute, existing rules promulgated under a prior statute, notice and public comment procedures are not required pursuant to 5 U.S.C. 553(b)(A) and (B), and a delayed effective date is not required pursuant to 5 U.S.C. 553(d)(2) and (3). Because no notice of proposed rulemaking is required, the provisions of the Regulatory Flexibility Act, 5 U.S.C. 601 (*et seq*.) do not apply. Further, because this Treasury decision is not a significant regulatory action for purposes of Executive Order 12866, a regulatory assessment is not required. Pursuant to section 7805(f) of the Code, these regulations were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Drafting Information

The principal author of these regulations is Tatiana Belenkaya, Office of Associate Chief Counsel (Procedure and Administration), Administrative Provisions and Judicial Practice Division.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

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

§§1.6015(a)–1 through 1.6015(j)–1 [Removed]

Par. 2. Sections 1.6015(a)–1 through 1.6015(j)–1 are removed.

Par. 3. Section 1.6654–2 is amended by:

1. Revising the last sentence of paragraph (e)(1)(ii).

2. Adding paragraphs (e)(5), (e)(6), and (e)(7).

The revision and additions read as follows:

§1.6654–2 Exceptions to imposition of the addition to the tax in the case of individuals.

* * * * *

(e)* * *

(1)* * *

(ii)* * * For rules with respect to the allocation of joint payments of estimated tax, see §1.6654–2(e)(5).

* * * * *

(5) *Joint payments of estimated tax*—(i) *In general.* A husband and wife may make a joint payment of estimated tax even though they are not living together. However, a joint payment of estimated tax may not be made if the husband and wife are separated under a decree of divorce or of separate maintenance. A joint payment of estimated tax may not be made if the taxpayer's spouse is a nonresident alien (including a nonresident alien who is a *bona fide* resident of Puerto Rico or a possession to which section 931 applies during the entire taxable year), unless an election is in effect for the taxable year under section 6013(g) or (h) and the regulations. In addition, a joint payment of estimated tax may not be made if the taxpayer's spouse has a taxable year different from that of the taxpayer. If a joint payment of estimated tax is made, the amount estimated as the income tax imposed by chapter 1 of the Internal Revenue Code must be computed on the aggregate estimated taxable income of the spouses (see section 6013(d)(3) and §1.2–1), whereas, if applicable, the amount estimated as the self-employment tax imposed by chapter 2 of the Internal Revenue Code must be computed on the separate estimated self-employment income of each spouse. See sections 1401 and 1402 and §1.6017–1(b)(1). The liability with respect to the estimated tax, in the case of a joint payment, shall be joint and several.

(ii) *Application to separate returns.* (A) Although a husband and wife may make a joint payment of estimated tax, they, nevertheless, can file separate returns. If they make a joint payment of estimated tax and file separate returns for the same taxable year with respect to which the joint payment was made, the payment made on account of the estimated tax for that taxable year may be treated as a payment on account of the tax liability of either the husband or wife for the taxable year, or may be divided between them in such manner as they may agree.

(B) In the event the husband and wife fail to agree to a division of the estimated tax payment, such payment shall be allocated between them in accordance with the following rule. The portion of such payment to be allocated to a taxpayer shall be that portion of the aggregate of all such payments as the amount of tax imposed by chapter 1 of the Internal Revenue Code shown on the separate return of the taxpayer (plus, if applicable, the amount of tax imposed by chapter 2 of the Internal Revenue Code shown on the return of the taxpayer) bears to the sum of the taxes imposed by chapter 1 of the Internal Revenue Code shown on the separate returns of the taxpayer and the spouse (plus, if applicable, the sum of the taxes imposed by chapter 2 of the Internal Revenue Code shown on the separate returns of the taxpayer and the spouse).

(6) *Example.* The rule described in paragraph (e)(5) of this section may be illustrated by the following example:

Example. (i) H and W make a joint payment of estimated tax of $19,500 for the taxable year. H and W subsequently file separate returns for the taxable year showing tax imposed by chapter 1 of the Internal Revenue Code in the amount of $11,500 and $8,000, respectively. In addition, H's return shows a tax imposed by chapter 2 of the Internal Revenue Code in the amount of $500. H and W fail to agree to a division of the estimated tax paid. The amount of the aggregate estimated tax payments allocated to H is determined as follows:

(A) Chapter 1 tax shown on H's return	$11,500
(B) Plus: Amount of tax imposed by chapter 2 shown on H's return	$500
(C) Total taxes imposed by chapter 1 and by chapter 2 shown on H's return	$12,000
(D) Amount of tax imposed by chapter 1 shown on W's return	$8,000
(E) Total taxes imposed by chapter 1 and by chapter 2 on both H's and W's returns	$20,000
(F) Proportion of taxes shown on H's return to total amount of taxes shown on both H's and W's returns	($12,000/$20,000) 60%
(G) Amount of estimated tax payments allocated to H (60% of $19,500)	$11,700

(ii) Accordingly, H's return would show a balance due in the amount of $300 ($12,000 taxes shown less $11,700 estimated tax allocated).

(7) *Death of spouse.* (i) A joint payment of estimated tax may not be made after the death of either the husband or wife. However, if it is reasonable for a surviving spouse to assume that there will be filed a joint return for himself and the deceased spouse for his taxable year and the last taxable year of the deceased spouse, he may, in making a separate payment of estimated tax for his taxable year which includes the period comprising such last taxable year of his spouse, estimate the amount of the tax imposed by chapter 1 of the Internal Revenue Code on his and his spouse's taxable income on an aggregate basis and compute his estimated tax with respect to chapter 1 tax in the same manner as though a joint return had been filed.

(ii) If a husband and wife make a joint payment of estimated tax and thereafter one spouse dies, no further payments of joint estimated tax liability are required from the estate of the decedent. The surviving spouse, however, shall be liable for the payment of any subsequent installments of the joint estimated tax. For the purpose of making an amended payment of estimated tax by the surviving spouse, and the allocation of payments made pursuant to a joint payment of estimated tax between the surviving spouse and the legal representative of the decedent in the event a joint return is not filed, the payment of estimated tax may be divided between the decedent and the surviving spouse in such proportion as the surviving spouse and the legal representative of the decedent may agree.

(iii) If the surviving spouse and the legal representative of the decedent fail to agree to a division of a payment, such payment shall be allocated in accordance with the following rule. The portion of such payment to be allocated to the surviving spouse shall be that portion of the aggregate amount of such payments as the amount of tax imposed by chapter 1 of the Internal Revenue Code shown on the separate return of the surviving spouse (plus, if applicable, the amount of tax imposed by chapter 2 of the Internal Revenue Code shown on the return of the surviving spouse) bears to the sum imposed by chapter 1 of the Internal Revenue Code shown on the separate returns of the surviving spouse and of the decedent (plus, if applicable, the sum of the taxes imposed by chapter 2 of the Internal Revenue Code shown on the returns of the surviving spouse and of the decedent); and the balance of such payments shall be allocated to the decedent. This rule may be illustrated by analogizing the surviving spouse described in this rule to H in the example contained in paragraph (e)(6) of this section and the decedent in this rule to W in that example.

Par. 4. Section 1.6654–3 is amended by revising paragraph (a) to read as follows:

§1.6654–3 Short taxable years of individuals.

(a) *In general*. The provisions of section 6654, with certain modifications relating to the application of section 6654(d), which are explained in paragraph (b) of this section, are applicable in the case of a short taxable year.

* * * * *

§1.6654–5 [Redesignated as §1.6654–7]

Par. 5. Section 1.6654–5 is redesignated as §1.6654–7.

Par. 6. New §1.6654–5 is added to read as follows:

§1.6654–5 Payments of estimated tax.

(a) *In general*. A payment of estimated tax by an individual shall be determined on Form 1040-ES. For the purpose of determining the estimated tax, the amount of gross income which the taxpayer can reasonably expect to receive or accrue, depending upon the method of accounting upon which taxable income is computed, and the amount of the estimated allowable deductions and credits to be taken into account in computing the amount of estimated tax, shall be determined upon the basis of the facts and circumstances existing at the time prescribed for determining the estimated tax, as well as those reasonably to be anticipated for the taxable year. If, therefore, the taxpayer is employed at the date prescribed for making an estimated tax payment at a given wage or salary, the taxpayer should presume, in the absence of circumstances indicating the contrary, for the purpose of the estimated tax payment that such employment will continue to the end of the taxable year at the wage or salary received by the taxpayer as of such date. In the case of income other than wages and salary, the regularity in the payment of income, such as dividends, interest, rents, royalties, and income arising from estates and trusts is a factor to be taken into consideration. Thus, if the taxpayer owns shares of stock in a corporation, and dividends have been paid regularly for several years upon the stock, the taxpayer should, in the absence of information indicating a change in the dividend policy, include the prospective dividends from the corporation for the taxable year as well as those actually received in such year prior to determining the estimated tax. In the case of a taxpayer engaged in business on his own account, there shall be made an estimate of gross income and deductions and credits in the light of the best available information affecting the trade, business, or profession.

(b) *Computation of estimated tax*. In computing the estimated tax, the taxpayer should take into account the taxes, credits, and other amounts listed in §1.6654–1(a)(4).

Par. 7. Section 1.6654–6 is added to read as follows:

§1.6654–6 Nonresident alien individuals.

(a) *In general*. A nonresident alien individual is required to make a payment of estimated tax if that individual's gross income meets the requirements of section 6654 and §1.6654–1. In making the determination under section 6654 as to whether the amount of the gross income of a nonresident alien individual is such as to require making a payment of estimated income tax, only the filing status relating to a single individual (other than a head of household) or to a married individual not entitled to file a joint return shall apply, unless an election is in effect for the taxable year under section 6013(g) or (h) and the regulations.

(b) *Determination of gross income*. To determine the gross income of a nonresident alien individual who is not, or does not expect to be, a *bona fide* resident of Puerto Rico or a possession to which section 931 applies during the entire taxable year, see section 872 and §§1.872–1 and 1.872–2. To determine the gross income of a nonresident alien individual who is, or expects to be, a *bona fide* resident of Puerto Rico or a possession to which section 931 applies during the entire taxable year, see section 876 and the regulations. For rules for determining whether an individual is a *bona fide* resident of a United States possession (including Puerto Rico), see section 937 and the regulations.

Mark E. Matthews,
Deputy Commissioner for Services and Enforcement.

Approved August 21, 2005.

Eric Solomon,
Acting Deputy Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on September 1, 2005, 8:45 a.m., and published in the issue of the Federal Register for September 2, 2005, 70 F.R. 52299)

Section 7520.—Valuation Tables

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 2005. See Rev. Rul. 2005-66, page 686.

Section 7872.—Treatment of Loans With Below-Market Interest Rates

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 2005. See Rev. Rul. 2005-66, page 686.

Part II. Treaties and Tax Legislation
Subpart A.—Tax Conventions and Other Related Items

Mexico LLC MAP Agreement

Announcement 2005–72

Following is a copy of the News Release issued by the Director, International (U.S. Competent Authority), on September 19, 2005 (IR–2005–107).

U.S., Mexico Reach Mutual Agreement Regarding Eligibility of Fiscally Transparent Entities Benefits

IR–2005–107, Sept. 19, 2005

WASHINGTON — On Aug. 26, 2005, the Competent Authorities of the United States and Mexico entered into a mutual agreement ("the Agreement") regarding the eligibility of entities that are treated as fiscally transparent under the laws of either Contracting State to benefits under the Convention Between the United States of America and the Government of the United Mexican States for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, along with a Protocol, signed on Sept. 18, 1992, and as amended by the Additional Protocol signed on Sept. 8, 1994, and the Second Additional Protocol signed on Nov. 26, 2002. The Agreement specifies the cases where fiscally transparent entities are entitled to treaty benefits and clarifies the procedure for claiming treaty benefits from Mexico

The text of the Agreement is as follows:

COMPETENT AUTHORITY MUTUAL AGREEMENT

The Competent Authorities of the United States and Mexico hereby enter into the following mutual agreement ("the Agreement") regarding the eligibility of entities that are treated as fiscally transparent under the laws of either Contracting State to benefits under the Convention Between the United States of America and the Government of the United Mexican States for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, along with a Protocol, signed on September 18, 1992, and as amended by the Additional Protocol signed on September 8, 1994, and the Second Additional Protocol signed on November 26, 2002. The Agreement specifies the cases where fiscally transparent entities are entitled to treaty benefits and clarifies the procedure for claiming treaty benefits from Mexico. The Agreement is entered into under paragraph 3 of Article 26 (Mutual Agreement Procedure).

1) *Eligibility of fiscally transparent entities for treaty benefits*

Paragraph 2(b) of the Protocol provides:

> For purposes of paragraph 1 of Article 4 it is understood that:
>
> * * * * *
>
> b) a partnership, estate, or trust is a resident of a Contracting State only to the extent that the income it derives is subject to tax in that State as the income of a resident, either in the hands of the partnership, estate or trust, or in the hands of its partners or beneficiaries;

The Competent Authorities agree that in applying paragraph 2(b) of the Protocol, it is understood that income from sources within one of the Contracting States received by an entity that is treated as fiscally transparent under the laws of either Contracting State, will be treated as income derived by a resident of the other Contracting State to the extent that such income is subject to tax as the income of a resident of the other Contracting State.

For example, if a resident of the United States is a member of a limited liability company ("LLC") organized in the United States, and the LLC is treated for U.S. federal tax purposes as a partnership, the resident of the United States would be afforded benefits of the Treaty on the income that the resident derives from Mexico through the LLC to the extent of the resident's share of that income. Similar rules would apply to a resident of the United States that is a shareholder of a U.S. subchapter S Corporation, an LLC that is disregarded as an entity separate from its owner, or a U.S. grantor trust.

It is understood that Mexican law currently does not provide for any fiscally transparent entities. However, if Mexico were to introduce legislation that provided for the creation of fiscally transparent entities, then it is intended that income received by such entity will be treated as income derived by a resident of Mexico to the extent that such income is subject to tax as the income of a resident of Mexico.

Additionally, Mexico agrees to apply this Agreement with respect to amounts paid to an entity created and subject to the laws of a third state or jurisdiction only where such third state or jurisdiction has in force a comprehensive exchange of information agreement as provided in Mexican tax provisions and such information is effectively exchanged. The following is the current list of countries that Mexico has a comprehensive exchange of information in force. Such a list is published under Mexican administrative regulations and may be amended from time to time.

- Belgium
- Canada
- Korea
- Israel
- Spain
- France
- Italy
- Norway
- Netherlands
- Singapore
- Sweden
- Finland
- Chile
- Ecuador
- Romania
- Czech Republic

2) *Appropriate procedures for claiming treaty benefits from Mexico*

A LLC or other entity organized within or without the United States that is treated as a partnership for U.S. tax purposes may claim treaty benefits by obtaining a certificate of residence on Form 6166 in the same manner as a partnership. A Form 6166 confirms the filing of Form 1065, U.S. Return of Partnership Income, by the LLC and includes a list of members of the LLC that are residents of the United States for purposes of U.S. taxation. The Form 6166 will inform the withholding agent to contact the LLC directly to provide information regarding the allocation of a particular payment to a specific member.

A U.S. resident deriving income through a LLC or other entity organized within or without the United States that is disregarded as an entity separate from its owner for U.S. tax purposes may claim benefits by obtaining a Form 6166 that provides that the LLC is a branch, division, or business unit of its single member owner and that such single member owner is a resident of the United States. A U.S. resident deriving income through a U.S. corporation that has made an election to be treated as an S Corporation for U.S. tax purposes may claim treaty benefits by obtaining a Form 6166 certificate of residence in a manner similar to that of a partnership. A Form 6166 confirms the filing of an information return, Form 1120S, U.S. Income Tax Return for an S Corporation, as required for a domestic S Corporation, and includes a list of shareholders that are residents of United States for purposes of U.S. taxation.

3) *Effective dates*

Upon signature by both competent authorities, this Agreement is effective with respect to Mexican source payments made to Mexican or U.S. entities to the extent the Mexican statute of limitations is open for such payments. This Agreement is effective with respect to Mexican source payments made to entities organized in third countries or jurisdictions identified in the Agreement as of January 1, 2006.

Agreed to by the undersigned Competent Authorities:

Robert H. Green U.S. Competent Authority	Ana Bertha Thierry Mexican Competent Authority
Date	Date

Part III. Administrative, Procedural, and Miscellaneous

Elections Under § 362(e)(2)(C)

Notice 2005–70

This notice provides guidance about how a valid election under § 362(e)(2)(C) of the Internal Revenue Code can be made pending the issuance of additional guidance.

BACKGROUND

Section 362(e) was enacted on October 22, 2004, as part of the American Jobs Creation Act of 2004, Pub. L. No. 108–357, 118 Stat. 1418. Section 362(e)(2)(A) of the Code generally provides that if property is transferred to a corporation as a capital contribution or in an exchange to which § 351 applies and the aggregate basis of the transferred property exceeds its aggregate value immediately after the transaction, then the transferee corporation's basis in such property shall not exceed the fair market value of such property. Under § 362(e)(2)(C), however, the transferor and transferee can make a joint election to reduce the transferor's basis in the stock received to its fair market value, and no reduction of the transferee's basis in the property received will be required. Section 362(e)(2)(C) provides that the election to reduce stock basis shall be filed with the return of tax for the taxable year in which the transaction occurred, shall be in such form and manner as the Secretary may prescribe, and, once made, shall be irrevocable. Section 362(e)(2)(A) does not apply, and the election under § 362(e)(2)(C) is not available, to exchanges subject to § 362(e)(1).

The Internal Revenue Service and Treasury Department are studying the issues raised by § 362(e), including the manner in which the election provided under § 362(e)(2)(C) might be made. In particular, the Service and Treasury Department are considering issuing guidance prescribing a particular form and manner for making the election. In the interim, the Service will treat elections as effective under § 362(e)(2)(C) if they are made in the form and manner of the certification set forth in this notice. The Service will also treat other statements on or with returns as effective elections under § 362(e)(2)(C) if they disclose sufficient information to apprise the Service that an election has been made with respect to a particular transaction and by particular parties.

PROCEDURES

If the transferor is not a controlled foreign corporation (CFC) as defined in § 957, the transferor may make a valid election by including a certification as described below on or with its tax return filed by the due date (including extensions) for filing its original return for the taxable year in which the transaction occurred. If the transferor is a CFC, its controlling U.S. shareholder(s), as defined in § 1.964–1(c)(5) of the Income Tax Regulations, may make a valid election for the CFC by including a certification as described below on or with each of their tax returns filed by the due date(s) (including extensions) for filing their original returns for the taxable year in which the transaction occurred.

If the election is made as described below, no election need be filed by the transferee (or any controlling U.S. shareholder thereof).

If the transferor is not a CFC, the transferor can make the election by providing the following certification: "[insert name and tax identification number of the taxpayer filing the return] certifies that [insert name and tax identification number of transferor] and [insert name and tax identification number of transferee] make an election under § 362(e)(2)(C) with respect to a transfer of property described in § 362(e)(2)(A) on [insert date(s) of transfer(s)]."

If the transferor is a CFC, its controlling U.S. shareholder(s) can make the election by providing the following certification: "[insert name and tax identification number of the taxpayer filing the return] certifies that [insert name and tax identification number, if any, of transferor (the CFC)], the controlling U.S. shareholder(s) of which is (are) [insert name(s) and tax identification number(s) of the controlling U.S. shareholder(s)], and [insert name and tax identification number, if any, of transferee] make an election under § 362(e)(2)(C) with respect to a transfer of property described in § 362(e)(2)(A) on [insert date(s) of transfer(s)]."

The common parent of a consolidated group of corporations can make the election on behalf of its members.

Taxpayers uncertain of the applicability of § 362(e)(2) to their transaction may make a protective election, which will have no effect in the event § 362(e)(2) does not apply to the transaction, but which will otherwise be binding and irrevocable.

EFFECTIVE DATE

This notice is effective for all elections under § 362(e)(2)(C) until further notice.

DRAFTING INFORMATION

The principal author of this notice is Jay Singer of the Office of Associate Chief Counsel (Corporate). Taxpayers with comments or questions about making an election under § 362(e)(2)(C) should contact Mr. Singer at (202) 622–7530 (not a toll-free call). Taxpayers with comments or questions about CFCs making an election under § 362(e)(2)(C) should contact Christopher Trump of the Office of Associate Chief Counsel (International) at (202) 622–3860 (not a toll-free call).

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26 CFR 601.201: Rulings and determination letters. (Also Part I, § 368.)

Rev. Proc. 2005–68

SECTION 1. PURPOSE

This revenue procedure amplifies Rev. Proc. 2005–1, 2005–1 I.R.B. 1, which explains how the Service provides advice to taxpayers on issues under the jurisdiction of the Associate Chief Counsel (Corporate), the Associate Chief Counsel (Financial Institutions and Products), the Associate Chief Counsel (Income Tax and Accounting), the Associate Chief Counsel (International), the Associate Chief Counsel (Passthroughs and Special Industries), the Associate Chief Counsel (Procedure and Administration), and the Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities).

This revenue procedure also amplifies Rev. Proc. 2005–3, 2005–1 I.R.B.

118, which sets forth the areas of the Internal Revenue Code under the jurisdiction of the Associate Chief Counsel (Corporate), the Associate Chief Counsel (Financial Institutions and Products), the Associate Chief Counsel (Income Tax and Accounting), the Associate Chief Counsel (Passthroughs and Special Industries), the Associate Chief Counsel (Procedure and Administration), and the Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities) relating to issues on which the Internal Revenue Service will not issue letter rulings or determination letters.

SECTION 2. BACKGROUND

.01 Current Procedures

Section 7 of Rev. Proc. 2005–1 provides general instructions for requesting letter rulings and determination letters. Section 7.02(4) of Rev. Proc. 2005–1 states that the Service ordinarily processes requests for letter rulings in order of the date received, and that expedited handling is granted only in rare and unusual cases.

Section 8.05(1) of Rev. Proc. 2005–1 provides that if a ruling request lacks essential information, the branch representative will tell the taxpayer that the request will be closed if the Associate does not receive the information within 21 calendar days from the date the information is requested, unless an extension of time is granted.

Section 3.01 of Rev. Proc. 2005–3 outlines specific questions and problems on which the Internal Revenue Service will not issue rulings or determination letters. Section 3.01(31) of Rev. Proc. 2005–3 provides that the Service will not rule on whether a transaction qualifies under § 332, § 351 or § 1036 for nonrecognition treatment, or whether it constitutes a corporate reorganization within the meaning of § 368(a)(1)(A) (including a transaction that qualifies under § 368(a)(1)(A) by reason of § 368(a)(2)(D) or § 368(a)(2)(E)), § 368(a)(1)(B), § 368(a)(1)(C), § 368(a)(1)(E), or § 368(a)(1)(F), and whether various consequences (such as nonrecognition and basis) result from the application of that section, unless the Service determines that there is a significant issue that must be resolved to decide those matters. If the Service determines that there is a significant issue, and to the extent the transaction is not described in another no-rule section, the Service will rule on the entire transaction, and not just the significant issue. Requests for rulings on whether a transaction constitutes an acquisitive corporate reorganization within the meaning of § 368(a)(1)(D) or § 368(a)(1)(G) or whether a transaction constitutes a corporate distribution under § 355 are not subject to the significant issue limitation.

Section 3.01(31) of Rev. Proc. 2005–3 further provides that a significant issue is an issue of law that meets the following tests: (1) the issue is not clearly and adequately addressed by a statute, regulation, decision of a court, tax treaty, revenue ruling, revenue procedure, notice, or other authority published in the Internal Revenue Bulletin; (2) the resolution of the issue is not essentially free from doubt; and (3) the issue is legally significant and germane to determining the major tax consequences of the transaction.

.02 New Procedures

The significant issue limitation set forth above is designed to increase the time available to the Service for processing letter rulings on transactions that involve the most difficult issues. Despite this willingness to rule on these transactions, the Service understands that taxpayers often execute transactions intended to qualify as reorganizations under § 368 that involve significant issues and distributions intended to qualify under § 355 without submitting letter ruling requests. Based on numerous comments from taxpayers and their representatives, the Service has concluded that this practice is attributable, in part, to the length of time typically associated with the letter ruling process.

The Service believes that it can better serve taxpayers and more effectively administer the internal revenue laws by resolving these issues through the private letter ruling program. Accordingly, to encourage taxpayer participation in this program, Section 7.02(4) of Rev. Proc. 2005–1 is amplified to provide expedited treatment for letter rulings on transactions intended to meet the requirements of either § 368 or § 355 for which such treatment is requested pursuant to this revenue procedure, subject to the restrictions of Section 3.01(31) of Rev. Proc. 2005–3. Instead of the typical processing period, the Service will endeavor to complete and issue letter rulings on these transactions within ten weeks from receipt of the request. It is the intention of the Service to process on an expedited basis all letter ruling requests on these transactions, provided the requirements of this revenue procedure are met. If these requirements are not met, the Service will process the letter ruling request in the usual manner. If the transaction involves an issue or issues not entirely within the jurisdiction of the Associate Chief Counsel (Corporate), the ruling request will be processed in the usual manner unless each Associate Chief Counsel having jurisdiction over the transaction agrees to process the ruling request on the expedited basis provided herein.

Section 8.05(1) of Rev. Proc. 2005–1 is amplified to provide that if an expedited ruling request lacks essential information, the branch representative will tell the taxpayer that the information must be submitted within 10 calendar days from the date of the request for additional information, unless an extension of time is granted. If the information is not submitted within 10 calendar days (with any extension) but is submitted within 21 calendar days (with any extension), the ruling request will be processed in the usual manner.

This revenue procedure also clarifies the term "significant issue," as defined in Section 3.01(31) of Rev. Proc. 2005–3, for all transactions to which the significant issue requirement applies, including transactions not being considered on an expedited basis.

This is a pilot program that applies to ruling requests postmarked or, if not mailed, received after September 14, 2005. This pilot program will be evaluated by the Service periodically.

SECTION 3. REQUEST FOR COMMENTS

The Service requests comments regarding the pilot program. Comments should refer to Rev. Proc. 2005–68, and should be submitted to:

Internal Revenue Service
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044
Attn: CC:PA:RU
Room 5226

or electronically via the Service internet site at:
Notice.Comments@irscounsel.treas.gov
(the Service comments e-mail address). All comments will be available for public inspection and copying.

SECTION 4. PROCEDURE

.01 Rev. Proc. 2005–1 is amplified by adding the following sentence to the first paragraph of section 7.02(4):

Notwithstanding the previous sentence, expedited handling may be available for certain transactions intended to qualify as reorganizations described in § 368 or distributions described in § 355 as provided in Rev. Proc. 2005–68, Section 4.02.

.02 Rev. Proc. 2005–1 is amplified by adding the following paragraphs to section 7.02(4):

EXPEDITED LETTER RULING PROCESS FOR REORGANIZATIONS AND FOR DISTRIBUTIONS UNDER SECTION 355: If a taxpayer requests a letter ruling on whether a transaction constitutes a reorganization under § 368 or a distribution under § 355 and asks for expedited handling pursuant to this provision, the Service will grant expedited handling. If expedited handling is granted, the Service will endeavor to complete and issue the letter ruling subject to Section 3.01(3) of Rev. Proc. 2005–3 within ten weeks after receiving the ruling request. If the transaction involves an issue or issues not entirely within the jurisdiction of the Associate Chief Counsel (Corporate), the letter ruling request will be processed in the usual manner, unless each Associate Chief Counsel having jurisdiction over an issue in the transaction agrees to process the letter ruling request on an expedited basis.

To initiate this process, the taxpayer must (i) state at the top of the first page of the request letter: "Expedited Handling is Requested" and (ii) provide the Associate Chief Counsel (Corporate) with a copy of the request letter by facsimile transmission (fax), without attachments, when the formal request is submitted. The fax copy should be sent to (202) 622–7707, Attn: CC:CORP (Expedite). In due course, the taxpayer must also provide the Associate Chief Counsel (Corporate) with a draft ruling letter setting forth the relevant facts, applicable representations, and requested rulings in a manner consistent with the format used by the Associate Chief Counsel (Corporate) in similar cases. See section 7.02(3) of Rev. Proc. 2005–1. In addition, the taxpayer must ensure that the formal submission of its letter ruling request complies with all of the requirements of Rev. Proc. 2005–1 (including the requirements of other applicable guidelines set forth in Appendix E of Rev. Proc. 2005–1). See section 8.05(1) of Rev. Proc. 2005–1 for a modified requirement regarding the submission of additional information. If the taxpayer does not satisfy the requirements of this paragraph, the letter ruling request will not be processed on an expedited basis, but instead will be processed in the usual manner.

.03 Rev. Proc. 2005–1 is also amplified by adding the following paragraph to section 8.05(1):

The Service will not endeavor to process a ruling request on the expedited basis provided by Rev. Proc. 2005–68, Section 4.02, unless the branch representative in Associate Chief Counsel (Corporate) receives all requested additional information within *10 calendar days* from the date of the request for such additional information, unless an extension of time is granted. If the information is not provided within 10 calendar days (with any extension) but is provided within 21 calendar days (with any extension), the letter ruling request will cease to be processed on an expedited basis and instead will be processed in the usual manner.

.04 Rev. Proc. 2005–3 is amplified by adding the following sentence as the last sentence in the paragraph entitled "Significant Issue" in section 3.01(31):

An issue of law will be considered not clearly and adequately addressed by the authorities above, and its resolution will not be essentially free from doubt when, because of concern over a legal issue (as opposed to a factual issue), taxpayer's counsel is unable to render an unqualified opinion on what the tax consequences of the transaction will be.

SECTION 5. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2005–1, 2005–1 I.R.B. 1 and Rev. Proc. 2005–3, 2005–1 I.R.B. 118 are amplified.

SECTION 6. EFFECTIVE DATE

This revenue procedure applies to all ruling requests postmarked or, if not mailed, received after September 14, 2005.

SECTION 7. PAPERWORK REDUCTION ACT

The collections of information in this revenue procedure have been previously reviewed and approved by the Office of Management and Budget (OMB) in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545–1522.

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

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 tax law. Generally tax returns and tax return information are confidential, as required by § 6103.

SECTION 8. DRAFTING INFORMATION

The principal author of this revenue procedure is Emidio J. Forlini, Jr. of the Office of Associate Chief Counsel (Corporate). For further information regarding this revenue procedure, contact Mr. Forlini at (202) 622–7930 (not a toll-free call).

Part IV. Items of General Interest

Notice of Proposed Rulemaking

Employer Comparable Contributions to Health Savings Accounts Under Section 4980G

REG–138647–04

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations providing guidance on employer comparable contributions to Health Savings Accounts (HSAs) under section 4980G. In general, these proposed regulations would affect employers that contribute to employees' HSAs.

DATES: Written or electronic comments and requests for a public hearing must be received by November 25, 2005.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–138647–04), room 5203, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–138647–04), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the IRS Internet site at *www.irs.gov/regs* or via the Federal eRulemaking Portal at *www.regulations.gov* (IRS - REG–138647–04).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Barbara E. Pie at (202) 622–6080; concerning submissions of comments or a request for a public hearing, Kelly Banks at (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed Pension Excise Tax Regulations (26 CFR part 54) under section 4980G of the Internal Revenue Code (Code). Under section 4980G of the Code, an excise tax is imposed on an employer that fails to make comparable contributions to the HSAs of its employees.

Section 1201 of the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (Act), Public Law 108–173, (117 Stat. 2066, 2003) added section 223 to the Code to permit eligible individuals to establish HSAs for taxable years beginning after December 31, 2003. Section 4980G was also added to the Code by the Act. Section 4980G(a) imposes an excise tax on the failure of an employer to make comparable contributions to the HSAs of its employees for a calendar year. Section 4980G(b) provides that rules and requirements similar to section 4980E (the comparability rules for Archer Medical Savings Accounts (Archer MSAs)) apply for purposes of section 4980G. Section 4980E(b) imposes an excise tax equal to 35% of the aggregate amount contributed by the employer to the Archer MSAs of employees during the calendar year if an employer fails to make comparable contributions to the Archer MSAs of its employees in a calendar year. Therefore, if an employer fails to make comparable contributions to the HSAs of its employees during a calendar year, an excise tax equal to 35% of the aggregate amount contributed by the employer to the HSAs of its employees during that calendar year is imposed on the employer. See Sections 4980G(a) and (b) and 4980E(b). See also Notice 2004–2, 2004–1 C.B. 269, Q & A–32.

Explanation of Provisions

Overview

The proposed regulations clarify and expand on the guidance regarding the comparability rules published in Notice 2004–2 and in Notice 2004–50, 2004–2 C.B. 196, Q & A–46 through Q & A–54.

I. *Comparable Contributions in General*

An employer is not required to contribute to the HSAs of its employees. However, in general, if an employer makes contributions to any employee's HSA, the employer must make comparable contributions to the HSAs of all comparable participating employees. Comparable participating employees are eligible individuals (as defined in section 223(c)(1)) who have the same category of high deductible health plan (HDHP) coverage. The categories of coverage are self-only HDHP coverage and family HDHP coverage.

These proposed regulations incorporate the rule in Notice 2004–2, Q & A–32 that contributions are comparable if they are either the same amount or the same percentage of the deductible for employees who are eligible individuals with the same category of coverage. An employer is not required to contribute the same amount or the same percentage of the deductible for employees who are eligible individuals with self-only HDHP coverage that it contributes for employees who are eligible individuals with family HDHP coverage. An employer that satisfies the comparability rules by contributing the same amount to the HSAs of all employees who are eligible individuals with self-only HDHP coverage is not required to contribute any amount to the HSAs of employees who are eligible individuals with family HDHP coverage, or to contribute the same percentage of the family HDHP deductible as the amount contributed with respect to self-only HDHP coverage. Similarly, an employer that satisfies the comparability rules by contributing the same amount to the HSAs of all employees who are eligible individuals with family HDHP coverage is not required to contribute any amount to the HSAs of employees who are eligible individuals with self-only HDHP coverage, or to contribute the same percentage

of the self-only HDHP deductible as the amount contributed with respect to family HDHP coverage.

II. *Calculating Comparable Contributions*

The proposed regulations clarify that contributions to the HSAs of certain individuals are not taken into account in determining whether an employer's contributions to the HSAs of its employees satisfy the comparability rules. Specifically, contributions to the HSAs of independent contractors, sole proprietors, and partners in a partnership are not taken into account under the comparability rules. In addition, the comparability rules do not apply to amounts rolled over from an employee's HSA or Archer MSA or to after-tax employee contributions.

The proposed regulations also clarify that the categories of employees for comparability testing are current full-time employees, current part-time employees, and former employees (except for former employees with coverage under the employer's HDHP because of an election under a COBRA continuation provision (as defined in section 9832(d)(1)). The proposed regulations provide that the comparability rules apply separately to each of the categories of employees. If an employer contributes to the HSA of any employee in a category of employees, the employer must make comparable contributions to the HSAs of all comparable participating employees within that category. Therefore, the comparability rules apply to a category of employees only if an employer contributes to the HSA of any employee within the category. For example, an employer that makes comparable contributions to the HSAs of all full-time employees who are eligible individuals but does not contribute to the HSA of any employee who is not a full-time employee, satisfies the comparability rules.

The categories of employees set forth in these proposed regulations are the exclusive categories for comparability testing. An employer must make comparable contributions to the HSAs of all comparable participating employees (eligible individuals who are in the same category of employees with the same category of HDHP coverage) during the calendar year without regard to any classification other than these categories. Therefore, the comparability rules do not apply separately to groups of collectively bargained employees. While the comparability rules apply separately to part-time employees, there is no similar rule permitting separate application of the comparability rules to collectively bargained employees. Neither section 4980E nor section 4980G provides an exception to the comparability rules for collectively bargained employees. Accordingly, an employer must make comparable contributions to the HSAs of all comparable participating employees, both those who are covered under a collective bargaining agreement and those who are not covered. Similarly, the comparability rules do not apply separately to management and non-management employees.

The proposed regulations also provide that the comparability rules apply separately to employees who have HSAs and employees who have Archer MSAs. However, if an employee has both an HSA and an Archer MSA, the employer may contribute to either the HSA or the Archer MSA, but not to both.

The proposed regulations incorporate the rule set forth in Q & A–53 of Notice 2004–50, which provides that if an employer limits HSA contributions to employees who are eligible individuals with coverage under an HDHP provided by the employer, the employer is not required to make comparable contributions to the HSAs of employees who are eligible individuals with coverage under an HDHP not provided by the employer. However, if an employer contributes to the HSAs of employees who are eligible individuals with coverage under any HDHP, in addition to the HDHPs provided by the employer, the employer is required to make comparable contributions to the HSAs of all comparable participating employees whether or not covered under the employer's HDHP. The proposed regulations also provide that similar rules apply to employer contributions to the HSAs of former employees. For example, if an employer limits HSA contributions to former employees who are eligible individuals with coverage under an HDHP provided by the employer, the employer is not required to make comparable contributions to the HSAs of former employees who are eligible individuals with coverage under an HDHP not provided by the employer. However, if an employer contributes to the HSAs of former employees who are eligible individuals with coverage under the employer's HDHP, the employer is not required to make comparable contributions to the HSAs of former employees who are eligible individuals with coverage under the employer's HDHP because of an election under a COBRA continuation provision (as defined in section 9832(d)(1)).

The proposed regulations also incorporate the rule set forth in Q & A–46 of Notice 2004–50, which provides that the comparability rules will not be satisfied if an employer makes HSA contributions in an amount equal to an employee's HSA contribution or a percentage of the employee's HSA contribution (matching contributions) because if all comparable participating employees do not contribute the same amount to their HSAs, they will not receive comparable contributions to their HSAs. In addition, the comparability rules will not be satisfied if an employer conditions contributions to an employee's HSA on an employee's participation in health assessments, disease management programs or wellness programs because if all comparable participating employees do not elect to participate in all the programs, they will not receive comparable contributions to their HSAs. See Q & A–48 of Notice 2004–50. Similarly, the comparability rules will not be satisfied if an employer makes additional contributions to the HSAs of all comparable participating employees who have attained a specified age or who have worked for the employer for a specified number of years, because if all comparable participating employees do not meet the age or length of service requirement, they will not receive comparable contributions to their HSAs. See Q & A–50 of Notice 2004–50.

III. *Procedures for Making Comparable Contributions*

The proposed regulations provide that in determining whether the comparability rules are satisfied, an employer must take into account all full-time and part-time employees who were eligible individuals for any month during the calendar year. An employee is an eligible individual if as of the first day of the month the employee meets all of the requirements set forth in section 223(c). An employer may comply

with the comparability rules by contributing amounts at one or more times for the calendar year to the HSAs of employees who are eligible individuals, if contributions are the same amount or the same percentage of the HDHP deductible for employees who are eligible individuals with the same category of coverage and are made at the same time (contributions on a pay-as-you-go basis).

An employer may also satisfy the comparability rules by determining comparable contributions for the calendar year at the end of the calendar year, taking into account all employees who were eligible individuals for any month during the calendar year and contributing the correct amount (a percentage of the HDHP deductible or a specified dollar amount for the same categories of coverage) to the employees' HSAs by April 15th of the following year (contributions on a look-back basis).

If an employer makes comparable HSA contributions on a pay-as-you-go basis, it must do so for each comparable participating employee who is an employee during the time period used to make contributions. For example, if an employer makes HSA contributions each pay period, it must do so for each comparable participating employee who is an employee during the pay period. If an employer makes comparable contributions on a look-back basis, it must do so for each employee who was a comparable participating employee for any month during the calendar year.

In addition, an employer may make all of its contributions to the HSAs of employees who are eligible individuals at the beginning of the calendar year (contributions on a pre-funded basis). An employer that makes comparable HSA contributions on a pre-funded basis will not fail to satisfy the comparability rules because an employee who terminates employment prior to the end of the calendar year has received more HSA contributions on a monthly basis than employees who worked the entire calendar year. If an employer makes HSA contributions on a pre-funded basis, it must do so for all employees who are comparable participating employees at the beginning of the calendar year. An employer that makes HSA contributions on a pre-funded basis must make comparable HSA contributions for all employees who are comparable participating employees for any month during the calendar year, including employees hired after the date of initial funding.

If an employee has not established an HSA at the time the employer funds its employee's HSAs, the employer complies with the comparability rules by contributing comparable amounts to the employee's HSA when the employee establishes the HSA, taking into account each month that the employee was a comparable participating employee. However, an employer is not required to make comparable contributions for a calendar year to an employee's HSA if the employee has not established an HSA by December 31st of the calendar year.

The proposed regulations provide that if an employer determines that the comparability rules are not satisfied for a calendar year, the employer may not recoup from an employee's HSA any portion of the employer's contribution to the employee's HSA because under section 223(d)(1)(E), an account beneficiary's interest in an HSA is nonforfeitable. However, an employer may make additional HSA contributions to satisfy the comparability rules. An employer may contribute up until April 15th following the calendar year in which the non-comparable contributions were made. An employer that makes additional HSA contributions to correct non-comparable contributions must also contribute reasonable interest.

IV. *Exception to the Comparability Rules for Cafeteria Plans*

The legislative history of the Act states that the comparability rules do not apply to HSA contributions that an employer makes through a cafeteria plan. See Conf. Rep. No. 391, 108th Cong., 1st Sess. 843 (2003), 2004 U.S.C.C.A.N. 1808. See also Notice 2004–2, Q & A–32. The nondiscrimination rules in section 125 of the Code apply to HSA contributions (including matching contributions) made through a cafeteria plan. Generally, a cafeteria plan is a written plan under which all participants are employees and participants may choose among two or more benefits consisting of cash and qualified benefits. Unlike the cafeteria plan nondiscrimination rules, the comparability rules are not based upon discrimination in favor of highly compensated or key employees. Therefore, an employer that maintains an HDHP only for highly compensated or key employees and makes HSA contributions through a cafeteria plan only for those eligible employees, does not violate the comparability rules, but may violate the cafeteria plan nondiscrimination rules.

V. *Waiver of Excise Tax*

In the case of a failure which is due to reasonable cause and not to willful neglect, all or a portion of the excise tax imposed under section 4980G may be waived to the extent that the payment of the tax would be excessive relative to the failure involved. See sections 4980G(b) and 4980E(c).

Proposed Effective Date

It is proposed that these regulations apply to employer contributions made on or after the date the final regulations are published in the **Federal Register**. However, taxpayers may rely on these regulations for guidance pending the issuance of final regulations.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. This notice of proposed rulemaking does not impose a collection of information on small entities, thus the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, these proposed regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The Treasury Department and the IRS specifically request comments on the clarity of the proposed rules and how they can be made easier

to understand. In addition, comments are requested on the application of the comparability rules to employees who are on leave pursuant to the Family and Medical Leave Act of 1993, Public Law 103–3, (107 Stat. 6, 1993, 29 U.S.C. 2601 *et seq*.). Comments are also requested concerning employer matching HSA contributions made through a cafeteria plan. Specifically, whether the ratio of an employer's matching HSA contributions to an employee's salary reduction HSA contributions should be limited, and whether employer matching contributions exceeding a specific limit should be subject to the section 4980G comparability rules. All comments will be available for public inspection and copying. A public hearing will be scheduled if requested in writing by any person that timely submits written comments.

Drafting Information

The principal author of these proposed regulations is Barbara E. Pie, Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities), Internal Revenue Service. However, personnel from other offices of the IRS and Treasury Department participated in their development.

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Proposed Amendment to the Regulations

Accordingly, 26 CFR part 54 is proposed to be amended as follows:

PART 54—PENSION EXCISE TAXES

Paragraph 1. The authority citation for part 54 is amended by adding an entry in numerical order to read, in part, as follows:

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

Sections 54.4980G–0, 54.4980G–1, 54.4980G–2, 54.4980G–3, 54.4980G–4, and 54.4980G–5 also issued under 26 U.S.C. 4980G. * * *

Paragraph 2. Sections 54.4980G–0, 54.4980G–1, 54.4980G–2, 54.4980G–3, 54.4980G–4, and 54.4980G–5 are added to read as follows:

§54.4980G–0 Table of contents

This section contains the questions for §54.4980G–1, §54.4980G–2, §54.4980G–3, §54.4980G–4, and §54.4980G–5.

§54.4980G–1 Failure of employer to make comparable health savings account contributions.

Q–1. What are the comparability rules that apply to employer contributions to Health Savings Accounts (HSAs)?

Q–2. What are the categories of HDHP coverage for purposes of applying the comparability rules?

Q–3. What is the testing period for making comparable contributions to employees' HSAs?

Q–4. How is the excise tax computed if employer contributions do not satisfy the comparability rules for a calendar year?

§54.4980G–2 Employer contribution defined.

Q–1. Do the comparability rules apply to amounts rolled over from an employee's HSA or Archer Medical Savings Account (Archer MSA)?

Q–2. If an employee requests that his or her employer deduct after-tax amounts from the employee's compensation and forward these amounts as employee contributions to the employee's HSA, do the comparability rules apply to these amounts?

§54.4980G–3 Definition of employee for comparability testing.

Q–1. Do the comparability rules apply to contributions that an employer makes to the HSAs of independent contractors?

Q–2. May a sole proprietor who is an eligible individual contribute to his or her own HSA without contributing to the HSAs of his or her employees who are eligible individuals?

Q–3. Do the comparability rules apply to contributions by a partnership to a partner's HSA?

Q–4. How are members of controlled groups treated when applying the comparability rules?

Q–5. What are the categories of employees for comparability testing?

Q–6. Is an employer permitted to make comparable contributions only to the HSAs of comparable participating employees who have coverage under the employer's HDHP?

Q–7. If an employee and his or her spouse are eligible individuals who work for the same employer and one employee-spouse has family coverage for both employees under the employer's HDHP, must the employer make comparable contributions to the HSAs of both employees?

Q–8. Does an employer that makes HSA contributions only for non-management employees who are eligible individuals, but not for management employees who are eligible individuals or that makes HSA contributions only for management employees who are eligible individuals but not for non-management employees who are eligible individuals satisfy the requirement that the employer make comparable contributions?

Q–9. If an employer contributes to the HSAs of former employees who are eligible individuals, do the comparability rules apply to these contributions?

Q–10. Is an employer permitted to make comparable contributions only to the HSAs of comparable participating former employees who have coverage under the employer's HDHP?

Q–11. If an employer contributes only to the HSAs of former employees who are eligible individuals with coverage under the employer's HDHP, must the employer make comparable contributions to the HSAs of former employees who are eligible individuals with coverage under the employer's HDHP because of an election under a COBRA continuation provision (as defined in section 9832(d)(1))?

Q–12. How do the comparability rules apply if some employees have HSAs and other employees have Archer MSAs?

§54.4980G–4 Calculating comparable contributions.

Q–1. What are comparable contributions?

Q–2. How do the comparability rules apply to employer contributions to employees' HSAs if some employees work full-time during the entire calendar year, and other employees work full-time for less than the entire calendar year?

Q–3. How does an employer comply with the comparability rules when some employees who are eligible individuals do not work for the employer during the entire calendar year?

Q–4. May an employer make all of its contributions to the HSAs of its employees who are eligible individuals at the beginning of the calendar year (*i.e.*, on a pre-funded basis) instead of contributing on a pay-as-you-go or on a look-back basis?

Q–5. Must an employer use the same contribution method as described in Q & A–3 and Q & A–4 of this section for all employees who were comparable participating employees for any month during the calendar year?

Q–6. How does an employer comply with the comparability rules if an employee has not established an HSA at the time the employer contributes to its employees' HSAs?

Q–7. If an employer bases its contributions on a percentage of the HDHP deductible, how is the correct percentage or dollar amount computed?

Q–8. Does an employer that contributes to the HSA of each comparable participating employee in an amount equal to the employee's HSA contribution or a percentage of the employee's HSA contribution (matching contributions) satisfy the rule that all comparable participating employees receive comparable contributions?

Q–9. If an employer conditions contributions by the employer to an employee's HSA on an employee's participation in health assessments, disease management programs or wellness programs and makes the same contributions available to all employees who participate in the programs, do the contributions satisfy the comparability rules?

Q–10. If an employer makes additional contributions to the HSAs of all comparable participating employees who have attained a specified age or who have worked for the employer for a specified number of years, do the contributions satisfy the comparability rules?

Q–11. If an employer makes additional contributions to the HSAs of all comparable participating employees who qualify for the additional contributions (HSA catch-up contributions) under section 223(b)(3), do the contributions satisfy the comparability rules?

Q–12. If an employer's contributions to an employee's HSA result in non-comparable contributions, may the employer recoup the excess amount from the employee's HSA?

§54.4980G–5 HSA comparability rules and cafeteria plans and waiver of excise tax.

Q–1. If an employer makes contributions through a section 125 cafeteria plan to the HSA of each employee who is an eligible individual are the contributions subject to the comparability rules?

Q–2. If an employer makes contributions through a cafeteria plan to the HSA of each employee who is an eligible individual in an amount equal to the amount of the employee's HSA contribution or a percentage of the amount of the employee's HSA contribution (*i.e.*, *matching contributions*), are the contributions subject to the section 4980G comparability rules?

Q–3. If an employer provides HDHP coverage through a cafeteria plan, but the employer's HSA contributions are not provided through the cafeteria plan, do the cafeteria plan nondiscrimination rules or the comparability rules apply to the HSA contributions?

Q–4. If under the employer's cafeteria plan, employees who are eligible individuals and who participate in health assessments, disease management programs or wellness programs receive an employer contribution to an HSA, unless the employees elect cash, are the contributions subject to the comparability rules?

Q–5. May all or part of the excise tax imposed under section 4980G be waived?

§54.4980G–1 Failure of employer to make comparable health savings account contributions.

Q–1. What are the comparability rules that apply to employer contributions to Health Savings Accounts (HSAs)?

A–1. If an employer makes contributions to any employee's HSA, the employer must make comparable contributions to the HSAs of all comparable participating employees. See Q & A–1 in §54.4980G–4 for the definition of comparable contributions. *Comparable participating employees* are eligible individuals (as defined in section 223(c)(1)) who have the same category of high deductible health plan (HDHP) coverage. See sections 4980G(b) and 4980E(d)(3). See section 223(c)(2) and (g) for the definition of an HDHP. See also Q & A–5 in §54.4980G–3 for the categories of employees and Q & A–2 in this section for the categories of HDHP coverage.

Q–2. What are the categories of HDHP coverage for purposes of applying the comparability rules?

A–2. The categories of coverage are self-only HDHP coverage and family HDHP coverage. See sections 4980G(b) and 4980E(d)(3)(B).

Q–3. What is the testing period for making comparable contributions to employees' HSAs?

A–3. To satisfy the comparability rules, an employer must make comparable contributions for the calendar year to the HSAs of employees who are comparable participating employees. See section 4980G(a).

Q–4. How is the excise tax computed if employer contributions do not satisfy the comparability rules for a calendar year?

A–4. (a) *Computation of tax*. If employer contributions do not satisfy the comparability rules for a calendar year, the employer is subject to an excise tax equal to 35% of the aggregate amount contributed by the employer to HSAs for that period.

(b) *Example*. The following example illustrates the rules in paragraph (a) of this Q & A–4:

Example. In this *Example*, assume that the HDHP provided by Employer A satisfies the definition of an HDHP for the 2007 calendar year. During the 2007 calendar year, Employer A has 8 employees who are eligible individuals with self-only coverage under an HDHP provided by Employer A. The deductible for the HDHP is $2,000. For the 2007 calendar year, Employer A contributes $2,000 each to the HSAs of two employees and $1,000 each to the HSAs of the other six employees, for total HSA contributions of $10,000. Employer A's contributions do not satisfy the comparability rules. Therefore, Employer A is subject to an excise tax of $3,500 (*i.e.*, 35% x $10,000) for its failure to make comparable contributions to its employees' HSAs.

§54.4980G–2 Employer contribution defined.

Q–1. Do the comparability rules apply to amounts rolled over from an employee's HSA or Archer Medical Savings Account (Archer MSA)?

A–1. No. The comparability rules do not apply to amounts rolled over from an employee's HSA or Archer MSA.

Q–2. If an employee requests that his or her employer deduct after-tax amounts from the employee's compensation and forward these amounts as employee con-

tributions to the employee's HSA, do the comparability rules apply to these amounts?

A–2. No. Section 106(d) provides that amounts contributed by an employer to an eligible employee's HSA shall be treated as employer-provided coverage for medical expenses and are excludible from the employee's gross income up to the limit in section 223(b). After-tax employee contributions to an HSA are not subject to the comparability rules because they are not employer contributions under section 106(d).

§54.4980G–3 Definition of employee for comparability testing.

Q–1. Do the comparability rules apply to contributions that an employer makes to the HSAs of independent contractors?

A–1. No. The comparability rules apply only to contributions that an employer makes to the HSAs of employees.

Q–2. May a sole proprietor who is an eligible individual contribute to his or her own HSA without contributing to the HSAs of his or her employees who are eligible individuals?

A–2. (a) *Sole proprietor not an employee*. Yes. The comparability rules apply only to contributions made by an employer to the HSAs of employees. Because a sole proprietor is not an employee, the comparability rules do not apply to contributions he or she makes to his or her own HSA. However, if a sole proprietor contributes to any employee's HSA, he or she must make comparable contributions to the HSAs of all comparable participating employees. In determining whether the comparability rules are satisfied, contributions that a sole proprietor makes to his or her own HSA are not taken into account.

(b) *Example*. The following example illustrates the rules in paragraph (a) of this Q & A–2:

Example. In a calendar year, B, a sole proprietor is an eligible individual and contributes $1,000 to B's own HSA. B also contributes $500 for the same calendar year to the HSA of each employee who is an eligible individual. The comparability rules are not violated by B's $1,000 contribution to B's own HSA.

Q–3. Do the comparability rules apply to contributions by a partnership to a partner's HSA?

A–3. (a) *Partner not an employee*. No. Contributions by a partnership to a *bona fide* partner's HSA are not subject to the comparability rules because the contributions are not contributions by an employer to the HSA of an employee. The contributions are treated as either guaranteed payments under section 707(c) or distributions under section 731. However, if a partnership contributes to the HSAs of employees who are not partners, the comparability rules apply to those contributions.

(b) *Example*. The following example illustrates the rules in paragraph (a) of this Q & A–3:

Example. (i) Partnership X is a limited partnership with three equal individual partners, A (a general partner), B (a limited partner), and C (a limited partner). C is to be paid $300 annually for services rendered to Partnership X in her capacity as a partner without regard to partnership income (a section 707(c) guaranteed payment). D and E are the only employees of Partnership X and are not partners in Partnership X. A, B, C, D, and E are eligible individuals and each has an HSA. During Partnership X's Year 1 taxable year, which is also a calendar year, Partnership X makes the following contributions—

(A) A $300 contribution to each of A's and B's HSAs which are treated as section 731 distributions to A and B;

(B) A $300 contribution to C's HSA in lieu of paying C the guaranteed payment directly; and

(C) A $200 contribution to each of D's and E's HSAs, who are comparable participating employees.

(ii) Partnership X's contributions to A's and B's HSAs are section 731 distributions, which are treated as cash distributions. Partnership X's contribution to C's HSA is treated as a guaranteed payment under section 707(c). The contribution is not excludible from C's gross income under section 106(d) because the contribution is treated as a distributive share of partnership income for purposes of all Code sections other than sections 61(a) and 162(a), and a guaranteed payment to a partner is not treated as compensation to an employee. Thus, Partnership X's contributions to the HSAs of A, B, and C are not subject to the comparability rules. Partnership X's contributions to D's and E's HSAs are subject to the comparability rules because D and E are employees of Partnership X and are not partners in Partnership X. Partnership X's contributions satisfy the comparability rules.

Q–4. How are members of controlled groups treated when applying the comparability rules?

A–4. All persons or entities treated as a single employer under section 414(b), (c), (m), or (o) are treated as one employer. See sections 4980G(b) and 4980E(e).

Q–5. What are the categories of employees for comparability testing?

A–5. (a) *Categories*. The categories of employees for comparability testing are as follows—

(1) Current full-time employees;

(2) Current part-time employees; and

(3) Former employees (except for former employees with coverage under the employer's HDHP because of an election under a COBRA continuation provision (as defined in section 9832(d)(1)).

(b) *Part-time and full-time employees*. Part-time employees are customarily employed for fewer than 30 hours per week and full-time employees are customarily employed for 30 or more hours per week. See sections 4980G(b) and 4980E(d)(4)(A) and (B).

(c) *In general*. The categories of employees in paragraph (a) of this Q & A–5 are the exclusive categories for comparability testing. An employer must make comparable contributions to the HSAs of all *comparable participating employees* (eligible individuals who are in the same category of employees with the same category of HDHP coverage) during the calendar year without regard to any classification other than these categories. Thus, the comparability rules do not apply separately to collectively bargained and non-collectively bargained employees. Similarly, the comparability rules do not apply separately to groups of collectively bargained employees.

Q–6. Is an employer permitted to make comparable contributions only to the HSAs of comparable participating employees who have coverage under the employer's HDHP?

A–6. (a) *Employer-provided HDHP coverage*. If during a calendar year, an employer contributes to the HSA of any employee who is an eligible individual covered under an HDHP provided by the employer, the employer is required to make comparable contributions to the HSAs of all comparable participating employees with coverage under any HDHP provided by the employer. An employer that contributes only to the HSAs of employees who are eligible individuals with coverage under the employer's HDHP is not required to make comparable contributions to HSAs of employees who are eligible individuals but are not covered under the employer's HDHP. However, an employer that contributes to the HSA of any employee who is an eligible individual with coverage under any HDHP, in addition to the HDHPs provided by the employer, must make comparable contributions to the HSAs of all comparable

participating employees whether or not covered under the employer's HDHP.

(b) *Examples*. The following examples illustrate the rules in paragraph (a) of this Q & A–6:

Example 1. In a calendar year, Employer C offers an HDHP to its full-time employees. Most full-time employees are covered under Employer C's HDHP and Employer C makes comparable contributions only to these employees' HSAs. Employee W, a full-time employee of Employer C and an eligible individual, is covered under an HDHP provided by W's spouse's employer and not under Employer C's HDHP. Employer C is not required to make comparable contributions to W's HSA.

Example 2. In a calendar year, Employer D does not offer an HDHP. Several full-time employees, who are eligible individuals, have HSAs. Employer D contributes to these employees' HSAs. Employer D must make comparable contributions to the HSAs of all full-time employees who are eligible individuals.

Example 3. In a calendar year, Employer E offers an HDHP to its full-time employees. Most full-time employees are covered under Employer E's HDHP and Employer E makes comparable contributions to these employees' HSAs and also to the HSAs of full-time employees who are eligible individuals and who are not covered under Employer E's HDHP. Employee H, a full-time employee of Employer E and a comparable participating employee, is covered under an HDHP provided by H's spouse's employer and not under Employer E's HDHP. Employer E must make comparable contributions to H's HSA.

Q–7. If an employee and his or her spouse are eligible individuals who work for the same employer and one employee-spouse has family coverage for both employees under the employer's HDHP, must the employer make comparable contributions to the HSAs of both employees?

A–7. (a) *In general*. If the employer makes contributions only to the HSAs of employees who are eligible individuals covered under its HDHP, the employer is not required to contribute to the HSAs of both employee-spouses. The employer is required to contribute to the HSA of the employee-spouse with coverage under the employer's HDHP, but is not required to contribute to the HSA of the employee-spouse covered under the employer's HDHP by virtue of his or her spouse's coverage. However, if the employer contributes to the HSA of any employee who is an eligible individual with coverage under any HDHP, the employer must make comparable contributions to the HSAs of both employee-spouses if they are both eligible individuals. If an employer is required to contribute to the HSAs of both employee-spouses, the employer is not required to contribute amounts in excess of the annual contribution limits in section 223(b).

(b) *Examples*. The following examples illustrate the rules in paragraph (a) of this Q & A–7:

Example 1. In a calendar year, Employer F offers an HDHP to its full-time employees. Most full-time employees are covered under Employer F's HDHP and Employer F makes comparable contributions only to these employees' HSAs. Employee H, a full-time employee of Employer F and an eligible individual has family coverage under Employer F's HDHP for H and H's spouse, Employee W, who is also a full-time employee of Employer F and an eligible individual. Employer F is required to make comparable contributions to H's HSA, but is not required to make comparable contributions to W's HSA.

Example 2. In a calendar year, Employer G offers an HDHP to its full-time employees. Most full-time employees are covered under Employer G's HDHP and Employer G makes comparable contributions to these employees' HSAs and to the HSAs of full-time employees who are eligible individuals but are not covered under Employer G's HDHP. Employee W, a full-time employee of Employer G and an eligible individual, has family coverage under Employer G's HDHP for W and W's spouse, Employee H, who is also a full-time employee of Employer G and an eligible individual. Employer G must make comparable contributions to W's HSA and to H's HSA.

Q–8. Does an employer that makes HSA contributions only for non-management employees who are eligible individuals, but not for management employees who are eligible individuals or that makes HSA contributions only for management employees who are eligible individuals but not for non-management employees who are eligible individuals satisfy the requirement that the employer make comparable contributions?

A–8. (a) *Management v. non-management*. No. If management employees and non-management employees are comparable participating employees, the comparability rules are not satisfied. However, if non-management employees are comparable participating employees and management employees are not comparable participating employees, the comparability rules may be satisfied. But see Q & A–1 in §54.4980G–5 on contributions made through a cafeteria plan.

(b) *Examples*. The following examples illustrate the rules in paragraph (a) of this Q & A–8:

Example 1. In a calendar year, Employer H maintains an HDHP covering all management and non-management employees. Employer H contributes $1,000 for the calendar year to the HSA of each non-management employee who is an eligible individual covered under its HDHP. Employer H does not contribute to the HSAs of any of its management employees who are eligible individuals covered under its HDHP. The comparability rules are not satisfied.

Example 2. In a calendar year, Employer J maintains an HDHP for non-management employees only. Employer J does not maintain an HDHP for its management employees. Employer J contributes $1,000 for the calendar year to the HSA of each non-management employee who is an eligible individual with coverage under its HDHP. Employer J does not contribute to the HSAs of any of its non-management employees not covered under its HDHP or to the HSAs of any of its management employees. The comparability rules are satisfied.

Example 3. In a calendar year, Employer K maintains an HDHP for management employees only. Employer K does not maintain an HDHP for its non-management employees. Employer K contributes $1,000 for the calendar year to the HSA of each management employee who is an eligible individual with coverage under its HDHP. Employer K does not contribute to the HSAs of any of its management employees not covered under its HDHP or to the HSAs of any of its non-management employees. The comparability rules are satisfied.

Q–9. If an employer contributes to the HSAs of former employees who are eligible individuals, do the comparability rules apply to these contributions?

A–9. (a) *Former employees*. Yes. The comparability rules apply to contributions an employer makes to former employees' HSAs. Therefore, if an employer contributes to any former employee's HSA, it must make comparable contributions to the HSAs of all comparable participating former employees (former employees who are eligible individuals with the same category of HDHP coverage). However, an employer is not required to make comparable contributions to the HSAs of former employees with coverage under the employer's HDHP because of an election under a COBRA continuation provision (as defined in section 9832(d)(1)). See Q & A–5 and Q & A–11 in this section. The comparability rules apply separately to former employees because they are a separate category of covered employee. See Q & A–5 in this section.

(b) *Examples*. The following examples illustrate the rules in paragraph (a) of this Q & A–9:

Example 1. In a calendar year, Employer L contributes $1,000 for the calendar year to the HSA of each current employee who is an eligible individual with coverage under any HDHP. Employer L does not contribute to the HSA of any former employee who is an eligible individual. Employer L's contributions satisfy the comparability rules.

Example 2. In a calendar year, Employer M contributes to the HSAs of current employees and former

employees who are eligible individuals covered under any HDHP. Employer M contributes $750 to the HSA of each current employee with self-only HDHP coverage and $1,000 to the HSA of each current employee with family HDHP coverage. Employer M also contributes $300 to the HSA of each former employee with self-only HDHP coverage and $400 to the HSA of each former employee with family HDHP coverage. Employer M's contributions satisfy the comparability rules.

Q–10. Is an employer permitted to make comparable contributions only to the HSAs of comparable participating former employees who have coverage under the employer's HDHP?

A–10. If during a calendar year, an employer contributes to the HSA of any former employee who is an eligible individual covered under an HDHP provided by the employer, the employer is required to make comparable contributions to the HSAs of all former employees who are comparable participating former employees with coverage under any HDHP provided by the employer. An employer that contributes only to the HSAs of former employees who are eligible individuals with coverage under the employer's HDHP is not required to make comparable contributions to the HSAs of former employees who are eligible individuals and who are not covered under the employer's HDHP. However, an employer that contributes to the HSA of any former employee who is an eligible individual with coverage under any HDHP, even if that coverage is not the employer's HDHP, must make comparable contributions to the HSAs of all former employees who are eligible individuals whether or not covered under an HDHP of the employer.

Q–11. If an employer contributes only to the HSAs of former employees who are eligible individuals with coverage under the employer's HDHP, must the employer make comparable contributions to the HSAs of former employees who are eligible individuals with coverage under the employer's HDHP because of an election under a COBRA continuation provision (as defined in section 9832(d)(1))?

A–11. No. An employer that contributes only to the HSAs of former employees who are eligible individuals with coverage under the employer's HDHP is not required to make comparable contributions to the HSAs of former employees who are eligible individuals with coverage under the employer's HDHP because of an election under a COBRA continuation provision (as defined in section 9832(d)(1)).

Q–12. How do the comparability rules apply if some employees have HSAs and other employees have Archer MSAs?

A–12. (a) *HSAs and Archer MSAs*. The comparability rules apply separately to employees who have HSAs and employees who have Archer MSAs. However, if an employee has both an HSA and an Archer MSA, the employer may contribute to either the HSA or the Archer MSA, but not to both.

(b) *Examples*. The following examples illustrate the rules in paragraph (a) of this Q & A–12:

Example 1. In a calendar year, Employer N contributes $600 to the Archer MSA of each employee who is an eligible individual and who has an Archer MSA. Employer N contributes $500 for the calendar year to the HSA of each employee who is an eligible individual and who has an HSA. If an employee has both an Archer MSA and an HSA, Employer N contributes to the employee's Archer MSA and not to the employee's HSA. Employee X has an Archer MSA and an HSA. Employer N contributes $600 for the calendar year to X's Archer MSA but does not contribute to X's HSA. Employer N's contributions satisfy the comparability rules.

Example 2. Same facts as *Example 1*, except that if an employee has both an Archer MSA and an HSA, Employer N contributes to the employee's HSA and not to the employee's Archer MSA. Employer N contributes $500 for the calendar year to X's HSA but does not contribute to X's Archer MSA. Employer N's contributions satisfy the comparability rules.

§54.4980G–4 Calculating comparable contributions.

Q–1. What are comparable contributions?

A–1. (a) *Definition*. Contributions are comparable if they are either the same amount or the same percentage of the deductible under the HDHP for employees who are eligible individuals with the same category of coverage. Employees with self-only HDHP coverage are tested separately from employees with family HDHP coverage. See Q & A–1 and Q & A–2 in §54.4980G–1. An employer is not required to contribute the same amount or the same percentage of the deductible for employees who are eligible individuals with self-only HDHP coverage that it contributes for employees who are eligible individuals with family HDHP coverage. An employer that satisfies the comparability rules by contributing the same amount to the HSAs of all employees who are eligible individuals with self-only HDHP coverage is not required to contribute any amount to the HSAs of employees who are eligible individuals with family HDHP coverage, or to contribute the same percentage of the family HDHP deductible as the amount contributed with respect to self-only HDHP coverage. Similarly, an employer that satisfies the comparability rules by contributing the same amount to the HSAs of all employees who are eligible individuals with family HDHP coverage is not required to contribute any amount to the HSAs of employees who are eligible individuals with self-only HDHP coverage, or to contribute the same percentage of the self-only HDHP deductible as the amount contributed with respect to family HDHP coverage.

(b) *Examples*. Assume that the HDHPs in *Example 1* through *Example 7* satisfy the definition of an HDHP for the 2007 calendar year. The following examples illustrate the rules in paragraph (a) of this Q & A–1:

Example 1. In the 2007 calendar year, Employer A offers its full-time employees three health plans, including an HDHP with self-only coverage and a $2,000 deductible. Employer A contributes $1,000 for the calendar year to the HSA of each employee who is an eligible individual electing the self-only HDHP coverage. Employer A makes no HSA contributions for employees with family HDHP coverage or for employees who do not elect the employer's self-only HDHP. Employer A's HSA contributions satisfy the comparability rules.

Example 2. In the 2007 calendar year, Employer B offers its employees an HDHP with a $3,000 deductible for self-only coverage and a $4,000 deductible for family coverage. Employer B contributes $1,000 for the calendar year to the HSA of each employee who is an eligible individual electing the self-only HDHP coverage. Employer B contributes $2,000 for the calendar year to the HSA of each employee who is an eligible individual electing the family HDHP coverage. Employer B's HSA contributions satisfy the comparability rules.

Example 3. In the 2007 calendar year, Employer C offers its employees an HDHP with a $1,500 deductible for self-only coverage and a $3,000 deductible for family coverage. Employer C contributes $1,000 for the calendar year to the HSA of each employee who is an eligible individual electing the self-only HDHP coverage. Employer C contributes $1,000 for the calendar year to the HSA of each employee who is an eligible individual electing the family HDHP coverage. Employer C's HSA contributions satisfy the comparability rules.

Example 4. In the 2007 calendar year, Employer D offers its employees an HDHP with a $1,500 deductible for self-only coverage and a $3,000 deductible for family coverage. Employer D contributes $1,500 for the calendar year to the HSA of each employee who is an eligible individual electing

the self-only HDHP coverage. Employer D contributes $1,000 for the calendar year to the HSA of each employee who is an eligible individual electing the family HDHP coverage. Employer D's HSA contributions satisfy the comparability rules.

Example 5. (i) In the 2007 calendar year, Employer E maintains two HDHPs. Plan A has a $2,000 deductible for self-only coverage and a $4,000 deductible for family coverage. Plan B has a $2,500 deductible for self-only coverage and a $4,500 deductible for family coverage. For the calendar year, Employer E makes contributions to the HSA of each full-time employee who is an eligible individual covered under Plan A of $600 for self-only coverage and $1,000 for family coverage. Employer E satisfies the comparability rules, if it makes either of the following contributions for the 2007 calendar year to the HSA of each full-time employee who is an eligible individual covered under Plan B—

(A) $600 for each full-time employee with self-only coverage and $1,000 for each full-time employee with family coverage; or

(B) $750 for each employee with self-only coverage and $1,125 for each employee with family coverage (the same percentage of the deductible Employer E contributes for full-time employees covered under Plan A, 30% of the deductible for self-only coverage and 25% of the deductible for family coverage).

(ii) Employer E also makes contributions to the HSA of each part-time employee who is an eligible individual covered under Plan A of $300 for self-only coverage and $500 for family coverage. Employer E satisfies the comparability rules, if it makes either of the following contributions for the 2007 calendar year to the HSA of each part-time employee who is an eligible individual covered under Plan B—

(A) $300 for each part-time employee with self-only coverage and $500 for each part-time employee with family coverage; or

(B) $375 for each part-time employee with self-only coverage and $563 for each part-time employee with family coverage (the same percentage of the deductible Employer E contributes for part-time employees covered under Plan A, 15% of the deductible for self-only coverage and 12.5% of the deductible for family coverage).

Example 6. (i) In the 2007 calendar year, Employer F maintains an HDHP. The HDHP has a $2,500 deductible for self-only coverage, and the following family coverage options—

(A) A $3,500 deductible for self plus one dependent;

(B) A $3,500 deductible for self plus spouse;

(C) A $3,500 deductible for self plus two or more dependents;

(D) A $3,500 deductible for self plus spouse and one dependent; and

(E) A $3,500 deductible for self plus spouse and two or more dependents.

(ii) Employer F makes the following contributions for the calendar year to the HSA of each full-time employee who is an eligible individual covered under the HDHP—

(A) $750 for self-only coverage;

(B) $1,000 for self plus one dependent;

(C) $1,000 for self plus spouse;

(D) $1,000 for self plus two or more dependents;

(E) $1,000 for self plus spouse and one dependent; and

(F) $1,000 for self plus spouse and two or more dependents.

(iii) Employer F's HSA contributions satisfy the comparability rules.

Example 7. (i) In the 2007 calendar year, Employer G maintains an HDHP. The HDHP has a $1,800 deductible for self-only coverage and the following family coverage options—

(A) A $3,500 deductible for self plus one dependent;

(B) A $3,800 deductible for self plus spouse;

(C) A $4,000 deductible for self plus two or more dependents;

(D) A $4,500 deductible for self plus spouse and one dependent; and

(E) A $5,000 deductible for self plus spouse and two or more dependents.

(ii) Employer G makes the following contributions for the calendar year to the HSA of each full-time employee who is an eligible individual covered under the HDHP—

(A) $360 for self-only coverage;

(B) $875 for self plus one dependent;

(C) $950 for self plus spouse;

(D) $1,000 for self plus two or more dependents;

(E) $1,125 for self plus spouse and one dependent; and

(F) $1,250 for self plus spouse and two or more dependents.

(iii) Employer G's HSA contributions satisfy the comparability rules because Employer G has made contributions that are the same percentage of the deductible for eligible employees with the same category of coverage (20% of the deductible for eligible employees with self-only coverage and 25% of the deductible for eligible employees with family coverage). Employer G could also satisfy the comparability rules by contributing the same dollar amount for each category of coverage.

Example 8. In a calendar year, Employer H offers its employees an HDHP and a health flexible spending arrangement (health FSA). The health FSA reimburses employees for medical expenses as defined in section 213(d). Some of Employer H's employees have coverage under the HDHP and the health FSA. For the calendar year, Employer H contributes $500 to the HSA of each employee who is an eligible individual, but does not contribute to the HSAs of employees who have coverage under the health FSA or under a spouse's health FSA. In addition, some of Employer H's employees have coverage under the HDHP and are enrolled in Medicare. Employer H does not contribute to the HSAs of employees who are enrolled in Medicare. The employees who have coverage under the health FSA or under a spouse's health FSA are not comparable participating employees because they are not eligible individuals under section 223(c)(1). Similarly, the employees who are enrolled in Medicare are not comparable participating employees because they are not eligible individuals under section 223(b)(7) and (c)(1). Therefore, employees who have coverage under the health FSA or under a spouse's health FSA and employees who are enrolled in Medicare are excluded from comparability testing. See sections 4980G(b) and 4980E. Employer H's contributions satisfy the comparability rules.

Q–2. How do the comparability rules apply to employer contributions to employees' HSAs if some employees work full-time during the entire calendar year, and other employees work full-time for less than the entire calendar year?

A–2. Employer contributions to the HSAs of employees who work full-time for less than twelve months satisfy the comparability rules if the contribution amount is comparable when determined on a month-to-month basis. For example, if the employer contributes $240 to the HSA of each full-time employee who works the entire calendar year, the employer must contribute $60 to the HSA of a full-time employee who works three months of the calendar year. The rules set forth in this Q & A–2 apply to employer contributions made on a pay-as-you-go basis or on a look-back basis as described in Q & A–3 in this section. See sections 4980G(b) and 4980E(d)(2)(B).

Q–3. How does an employer comply with the comparability rules when some employees who are eligible individuals do not work for the employer during the entire calendar year?

A–3. (a) *In general*. In determining whether the comparability rules are satisfied, an employer must take into account all full-time and part-time employees who were employees and eligible individuals for any month during the calendar year. (Full-time and part-time employees are tested separately. See Q & A–5 in §54.4980G–3.) There are two methods to comply with the comparability rules when some employees who are eligible individuals do not work for the employer during the entire calendar year; contributions may be made on a pay-as-you-go basis or on a look-back basis. See Q & A–9 through Q & A–11 in §54.4980G–3 for the rules regarding comparable contributions to the HSAs of former employees.

(b) *Contributions on a pay-as-you-go basis*. An employer may comply with the comparability rules by contributing amounts at one or more times for the calendar year to the HSAs of employees who are eligible individuals, if contributions are the same amount or the same percentage of the HDHP deductible for employees who are eligible individuals as of the first day of the month with the same category of coverage and are made at the same time. Contributions made at the employer's usual payroll interval for different groups of employees are considered to be

made at the same time. For example, if salaried employees are paid monthly and hourly employees are paid bi-weekly, an employer may contribute to the HSAs of hourly employees on a bi-weekly basis and to the HSAs of salaried employees on a monthly basis. An employer may change the amount that it contributes to the HSAs of employees at any point. However, the changed contribution amounts must satisfy the comparability rules.

(c) *Examples*. The following examples illustrate the rules in paragraph (b) of this Q & A–3:

Example 1. (i) Beginning on January 1st, Employer J contributes $50 per month on the first day of each month to the HSA of each employee who is an eligible individual. Employer J does not contribute to the HSAs of former employees. In mid-March of the same year, Employee X, an eligible individual, terminates employment after Employer J has contributed $150 to X's HSA. After X terminates employment, Employer J does not contribute additional amounts to X's HSA. In mid-April of the same year, Employer J hires Employee Y, an eligible individual, and contributes $50 to Y's HSA in May and $50 in June. Effective in July of the same year, Employer J stops contributing to the HSAs of all employees and makes no contributions to the HSA of any employee for the months of July through December. In August, Employer J hires Employee Z, an eligible individual. Employer J does not contribute to Z's HSA. After Z is hired, Employer J does not hire additional employees. As of the end of the calendar year, Employer J has made the following HSA contributions to its employees' HSAs—

(A) Employer J contributed $150 to X's HSA;

(B) Employer J contributed $100 to Y's HSA;

(C) Employer J did not contribute to Z's HSA; and

(D) Employer J contributed $300 to the HSA of each employee who was an eligible individual and employed by Employer J from January through June.

(ii) Employer J's contributions satisfy the comparability rules.

Example 2. In a calendar year, Employer K offers its employees an HDHP and contributes on a monthly pay-as-you-go basis to the HSAs of employees who are eligible individuals with coverage under Employer K's HDHP. In the calendar year, Employer K contributes $50 per month to the HSA of each of employee with self-only HDHP coverage and $100 per month to the HSA of each employee with family HDHP coverage. From January 1st through March 30th of the calendar year, Employee X is an eligible individual with self-only HDHP coverage. From April 1st through December 30th of the calendar year, X is an eligible individual with family HDHP coverage. For the months of January, February and March of the calendar year, Employer K contributes $50 per month to X's HSA. For the remaining months of the calendar year, Employer K contributes $100 per month to X's HSA. Employer K's contributions to X's HSA satisfy the comparability rules.

(d) *Contributions on a look-back basis*. An employer may also satisfy the comparability rules by determining comparable contributions for the calendar year at the end of the calendar year, taking into account all employees who were eligible individuals for any month during the calendar year and contributing the correct amount (a percentage of the HDHP deductible or a specified dollar amount for the same categories of coverage) to the employees' HSAs.

(e) *Example*. The following example illustrates the rules in paragraph (d) of this Q & A–3:

Example. In a calendar year, Employer L offers its employees an HDHP and contributes on a look-back basis to the HSAs of employees who are eligible individuals with coverage under Employer L's HDHP. Employer L contributes $600 (*i.e.* $50 per month) for the calendar year to the HSA of each of employee with self-only HDHP coverage and $1,200 (*i.e.*, $100 per month) for the calendar year to the HSA of each employee with family HDHP coverage. From January 1st through June 30th of the calendar year, Employee Y is an eligible individual with family HDHP coverage. From July 1st through December 31, Y is an eligible individual with self-only HDHP coverage. Employer L contributes $900 on a look-back basis for the calendar year to Y's HSA ($100 per month for the months of January through June and $50 per month for the months of July through December). Employer L's contributions to Y's HSA satisfy the comparability rules.

Q–4. May an employer make all of its contributions to the HSAs of its employees who are eligible individuals at the beginning of the calendar year (*i.e.*, on a pre-funded basis) instead of contributing on a pay-as-you-go or on a look-back basis?

A–4. (a) *Contributions on a pre-funded basis*. Yes. An employer may make all of its contributions to the HSAs of its employees who are eligible individuals at the beginning of the calendar year. An employer that pre-funds the HSAs of its employees will not fail to satisfy the comparability rules because an employee who terminates employment prior to the end of the calendar year has received more contributions on a monthly basis than employees who have worked the entire calendar year. See Q & A–12 in this section. Under section 223(d)(1)(E), an account beneficiary's interest in an HSA is nonforfeitable. An employer must make comparable contributions for all employees who are comparable participating employees for any month during the calendar year, including employees who are eligible individuals hired after the date of initial funding. An employer that makes HSA contributions on a pre-funded basis may also contribute on a pre-funded basis to the HSAs of employees who are eligible individuals hired after the date of initial funding. Alternatively, an employer that has pre-funded the HSAs of comparable participating employees may contribute to the HSAs of employees who are eligible individuals hired after the date of initial funding on a pay-as-you-go basis or on a look-back basis. An employer that makes HSA contributions on a pre-funded basis must use the same contribution method for all employees who are eligible individuals hired after the date of initial funding.

(b) *Example*. The following example illustrates the rules in paragraph (a) of this Q & A–4:

Example. (i) On January 1, Employer M contributes $1,200 for the calendar year on a pre-funded basis to the HSA of each of employee who is an eligible individual. In mid-May, Employer M hires Employee B, an eligible individual. Therefore, Employer M is required to make comparable contributions to B's HSA beginning in June. Employer M satisfies the comparability rules with respect to contributions to B's HSA if it makes HSA contributions in any one of the following ways—

(A) Pre-funding B's HSA by contributing $700 to B's HSA;

(B) Contributing $100 per month on a pay-as-you-go basis to B's HSA; or

(C) Contributing to B's HSA at the end of the calendar year taking into account each month that B was an eligible individual and employed by Employer M.

(ii) If Employer M hires additional employees who are eligible individuals after initial funding, it must use the same contribution method for these employees that it used to contribute to B's HSA.

Q–5. Must an employer use the same contribution method as described in Q & A–3 and Q & A–4 of this section for all employees who were comparable participating employees for any month during the calendar year?

A–5. Yes. If an employer makes comparable HSA contributions on a pay-as-you-go basis, it must do so for each employee who is a comparable participating employee during the pay period. If an employer makes comparable contributions on a look-back basis, it must do so for each employee who was a comparable participating employee for any month during the calendar year. If an employer makes HSA contributions on a pre-funded basis, it must do so for all employees who are comparable participating employees at the beginning of the calendar year. An employer that contributes on a pre-funded basis must

make comparable HSA contributions for all employees who are comparable participating employees for any month during the calendar year, including employees who are eligible individuals hired after the date of initial funding. See Q & A–4 in this section for rules regarding contributions for employees hired after initial funding.

Q–6. How does an employer comply with the comparability rules if an employee has not established an HSA at the time the employer contributes to its employees' HSAs?

A–6. (a) *Employee has not established an HSA*. If an employee has not established an HSA at the time the employer funds its employees' HSAs, the employer complies with the comparability rules by contributing comparable amounts to the employee's HSA when the employee establishes the HSA, taking into account each month that the employee was a comparable participating employee. However, an employer is not required to make comparable contributions for a calendar year to an employee's HSA if the employee has not established an HSA by December 31st of the calendar year.

(b) *Example*. The following example illustrates the rules in paragraph (a) of this Q & A–6:

Example. Beginning on January 1st, Employer N contributes $500 per calendar year on a pay-as-you-go basis to the HSA of each employee who is an eligible individual. Employee C is an eligible individual during the entire calendar year but does not establish an HSA until March. Notwithstanding C's delay in establishing an HSA, Employer N must make up the missed HSA contributions for January and February by April 15th of the following calendar year.

Q–7. If an employer bases its contributions on a percentage of the HDHP deductible, how is the correct percentage or dollar amount computed?

A–7. (a) *Computing HSA contributions*. The correct percentage is determined by rounding to the nearest 1/100th of a percentage point and the dollar amount is determined by rounding to the nearest whole dollar.

(b) *Example*. The following example illustrates the rules in paragraph (a) of this Q & A–7:

Example. In this *Example*, assume that the HDHP provided by Employer P satisfies the definition of an HDHP for the 2007 calendar year. In the 2007 calendar year, Employer P maintains two HDHPs. Plan A has a deductible of $3,000 for self-only coverage. Employer P contributes $1,000 for the calendar year to the HSA of each employee covered under Plan A. Plan B has a deductible of $3,500 for self-only coverage. Employer P satisfies the comparability rules if it makes either of the following contributions for the 2007 calendar year to the HSA of each employee who is an eligible individual with self-only coverage under Plan B—

(i) $1,000; or

(ii) $1,167 (33.33% of the deductible rounded to the nearest whole dollar amount).

Q–8. Does an employer that contributes to the HSA of each comparable participating employee in an amount equal to the employee's HSA contribution or a percentage of the employee's HSA contribution (matching contributions) satisfy the rule that all comparable participating employees receive comparable contributions?

A–8. No. If all comparable participating employees do not contribute the same amount to their HSAs and, consequently, do not receive comparable contributions to their HSAs, the comparability rules are not satisfied, notwithstanding that the employer offers to make available the same contribution amount to each comparable participating employee. But see Q & A–1 in §54.4980G–5 on contributions to HSAs made through a cafeteria plan.

Q–9. If an employer conditions contributions by the employer to an employee's HSA on an employee's participation in health assessments, disease management programs or wellness programs and makes the same contributions available to all employees who participate in the programs, do the contributions satisfy the comparability rules?

A–9. No. If all comparable participating employees do not elect to participate in all the programs and consequently, all comparable participating employees do not receive comparable contributions to their HSAs, the employer contributions fail to satisfy the comparability rules. But see Q & A–1 in §54.4980G–5 on contributions made to HSAs through a cafeteria plan.

Q–10. If an employer makes additional contributions to the HSAs of all comparable participating employees who have attained a specified age or who have worked for the employer for a specified number of years, do the contributions satisfy the comparability rules?

A–10. No. If all comparable participating employees do not meet the age or length of service requirement, all comparable participating employees do not receive comparable contributions to their HSAs and the employer contributions fail to satisfy the comparability rules.

Q–11. If an employer makes additional contributions to the HSAs of all comparable participating employees who qualify for the additional contributions (HSA catch-up contributions) under section 223(b)(3), do the contributions satisfy the comparability rules?

A–11. No. If all comparable participating employees do not qualify for the additional HSA contributions under section 223(b)(3), all comparable participating employees do not receive comparable contributions to their HSAs, and the employer contributions fail to satisfy the comparability rules.

Q–12. If an employer's contributions to an employee's HSA result in non-comparable contributions, may the employer recoup the excess amount from the employee's HSA?

A–12. No. An employer may not recoup from an employee's HSA any portion of the employer's contribution to the employee's HSA. Under section 223(d)(1)(E), an account beneficiary's interest in an HSA is nonforfeitable. However, an employer may make additional HSA contributions to satisfy the comparability rules. An employer may contribute up until April 15th following the calendar year in which the non-comparable contributions were made. An employer that makes additional HSA contributions to correct non-comparable contributions must also contribute reasonable interest. However, an employer is not required to contribute amounts in excess of the annual contribution limits in section 223(b).

§54.4980G–5 HSA comparability rules and cafeteria plans and waiver of excise tax.

Q–1. If an employer makes contributions through a section 125 cafeteria plan to the HSA of each employee who is an eligible individual, are the contributions subject to the comparability rules?

A–1. No. The comparability rules do not apply to HSA contributions that an employer makes through a section 125 cafeteria plan. However, contributions to an HSA made under a cafeteria plan are subject to the section 125 nondiscrimination rules (eligibility rules, contributions and

benefits tests and key employee concentration tests). See section 125(b), (c) and (g) and Prop. Treas. Reg. §1.125–1, Q & A–19, (49 FR 19321).

Q–2. If an employer makes contributions through a cafeteria plan to the HSA of each employee who is an eligible individual in an amount equal to the amount of the employee's HSA contribution or a percentage of the amount of the employee's HSA contribution (*i.e.*, *matching contributions*), are the contributions subject to the section 4980G comparability rules?

A–2. No. The comparability rules do not apply to HSA contributions that an employer makes through a section 125 cafeteria plan. Thus, where matching contributions are made by an employer through a cafeteria plan, the contributions are not subject to the comparability rules of section 4980G. However, contributions, including matching contributions, to an HSA made under a cafeteria plan are subject to the section 125 nondiscrimination rules (eligibility rules, contributions and benefits tests and key employee concentration tests). See Q & A–1 in this section.

Q–3. If an employer provides HDHP coverage through a cafeteria plan, but the employer's HSA contributions are not provided through the cafeteria plan, do the cafeteria plan nondiscrimination rules or the comparability rules apply to the HSA contributions?

A–3. (a) *HDHP provided through cafeteria plan*. The comparability rules in section 4980G apply to the HSA contributions. The cafeteria plan nondiscrimination rules apply only to HSA contributions made through a cafeteria plan irrespective of whether the HDHP is provided through a cafeteria plan.

(b) *Example*. The following example illustrates the rules in paragraph (a) of this Q & A–3:

Example. Employer A provides HDHP coverage through its cafeteria plan. Employer A automatically contributes to the HSA of each employee who is an eligible individual with HDHP coverage through the cafeteria plan. Employees make no election with respect to Employer A's HSA contributions and have no right to receive cash or other taxable benefits in lieu of the HSA contributions. Employer A contributes only to the HSAs of employees who have elected HDHP coverage through the cafeteria plan. The comparability rules apply to Employer A's HSA contributions because the HSA contributions are not made through the cafeteria plan.

Q–4. If under the employer's cafeteria plan, employees who are eligible individuals and who participate in health assessments, disease management programs or wellness programs receive an employer contribution to an HSA, unless the employees elect cash, are the contributions subject to the comparability rules?

A–4. No. The comparability rules do not apply to employer contributions to an HSA made through a cafeteria plan. See Q & A–1 in this section.

Q–5. May all or part of the excise tax imposed under section 4980G be waived?

A–5. In the case of a failure which is due to reasonable cause and not to willful neglect, all or a portion of the excise tax imposed under section 4980G may be waived to the extent that the payment of the tax would be excessive relative to the failure involved. See sections 4980G(b) and 4980E(c).

Mark E. Matthews,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on August 25, 2005, 8:45 a.m., and published in the issue of the Federal Register for August 26, 2005, 70 F.R. 50233)

Notice of Proposed Rulemaking

Application of the Federal Insurance Contributions Act to Payments Made for Certain Services

REG–104143–05

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed amendments to regulations relating to payments made for service not in the course of the employer's trade or business, for domestic service in a private home of the employer, for agricultural labor, and for service performed as a home worker within the meaning of section 3121(d)(3)(C) of the Internal Revenue Code (Code). These proposed amendments would provide guidance concerning the application of the Federal Insurance Contributions Act (FICA) to these payments. These proposed amendments would affect employers that make these payments and employees that receive these payments. These proposed amendments would provide guidance to assist these taxpayers in complying with the law.

DATES: Written or electronic comments and requests for a public hearing must be received by November 25, 2005.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–104143–05), room 5203, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to: CC:PA:LPD:PR (REG–104143–05), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, or sent electronically, via the IRS Internet site at *www.irs.gov/regs* or via the Federal eRulemaking Portal at *http://www.regulations.gov/* (IRS REG–104143–05).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, please contact Paul Carlino of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities), (202) 622–0047; concerning submissions of comments or to request a public hearing, please contact LaNita Van Dyke, (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed amendments to the Employment Tax Regulations (26 CFR part 31) under sections 3102, 3121(a), 3121(a)(7), 3121(a)(8), 3121(a)(10), and 3121(i) of the Code. The Federal Insurance Contributions Act (FICA) generally imposes tax on each employer and employee. Under section 3111, FICA tax is imposed on the employer in an amount equal to a percentage of the wages paid by that employer. Under section 3101, FICA tax is also imposed on the employee in an amount equal to a percentage of the wages received by the employee with respect to employment. Section 3102 requires the employer to collect the tax imposed under section 3101 by deducting and

withholding the amount of the tax from the wages as and when paid. Section 3121(a) defines wages for FICA tax purposes as all remuneration for employment unless otherwise excepted. Sections 3121(a)(7) (relating to domestic service in a private home of the employer and to service not in the course of the employer's trade or business), 3121(a)(8) (relating to agricultural labor) and 3121(a)(10) (relating to service performed as a home worker within the meaning of section 3121(d)(3)(C)) provide exceptions to the definition of wages for FICA tax purposes. Section 3121(i)(1) provides that in the case of domestic service described in section 3121(a)(7)(B), any payment of cash remuneration for such service which is more or less than a whole-dollar amount, to the extent prescribed by regulations, may be computed to the nearest dollar.

Section 3102(a) provides that an employer may deduct an amount equivalent to the FICA tax imposed by section 3101 from any payment of cash remuneration to which sections 3121(a)(7)(B), 3121(a)(7)(C), 3121(a)(8)(B) and 3121(a)(10) apply, even though at the time of payment the total amount of such remuneration paid to the employee by the employer in the calendar year is less than the dollar threshold amount used to determine whether the remuneration is wages for FICA tax purposes. An employer that chooses to withhold FICA taxes imposed by section 3101 prior to reaching the dollar threshold amount used to determine whether the remuneration is wages for FICA tax purposes must repay the employee the withheld amount if the dollar threshold is not met in the calendar year. If the withheld amount has been deposited, the employer must repay or reimburse the employee the withheld amount in accordance with the rules under §31.6413(a)–1 of the regulations.

Changes to sections 3102(a) and 3121(a)(7)(B) were made by section 2(a)(1) of the Social Security Domestic Employment Reform Act of 1994, (SSDERA), Public Law 103–387 (108 Stat. 4071). The SSDERA also added section 3121(x). Changes to section 3102(a) were made by section 424(b) of the Social Security Protection Act of 2004 (SSPA), Public Law 108–203 (118 Stat. 493, 536). Changes to section 3121(a)(8)(B) were made by section 8017(b) of the Technical and Miscellaneous Revenue Act of 1988 (the 1988 Act), Public Law 100–647 (102 Stat. 3342, 3793) and section 9002(b) of the Omnibus Budget Reconciliation Act of 1987 (the 1987 Act), Public Law 100–203 (101 Stat. 1330, 1330–287). Changes to sections 3102(a), 3121(a)(7)(C) and 3121(a)(10) were made by sections 355(a) and 356(a) of the Social Security Amendments of 1977 (the 1977 Act), Public Law 95–216 (91 Stat. 1509, 1555). These statutory changes are not reflected in the existing regulations of §§31.3102–1, 31.3121(a)–2, 31.3121(a)(7)–1, 31.3121(a)(8)–1, 31.3121(a)(10)–1, and 31.3121(i)–1. These proposed regulations would amend these existing regulations to reflect the statutory changes.

Domestic Service in a Private Home of the Employer

Section 3121(a)(7)(B) provides an exclusion from wages for FICA tax purposes of certain cash remuneration paid by an employer to an employee for domestic service in a private home of the employer. The SSDERA amended the dollar threshold amount and time period used to determine the exclusion under section 3121(a)(7)(B). The SSDERA also added section 3121(x).

Prior to SSDERA, section 3121(a)(7)(B) provided that cash remuneration paid by an employer in any calendar quarter to an employee for domestic service in a private home of the employer was excluded from wages for FICA tax purposes if the cash remuneration paid in such quarter by the employer to the employee for such service was less than $50. The SSDERA amended section 3121(a)(7)(B) to provide that cash remuneration paid by an employer in any calendar year to an employee for domestic service in a private home of the employer is excluded from wages for FICA tax purposes if the cash remuneration paid in such year by the employer to the employee for such service is less than the applicable dollar threshold (as defined in section 3121(x)) for such year. SSDERA is effective for cash remuneration paid after December 31, 1993.

The applicable dollar threshold (as defined in section 3121(x)) is $1,000 for calendar year 1995. The applicable dollar threshold is adjusted annually under the formula described in section 215(a)(1)(B)(ii) of the Social Security Act, Public Law 74–271 (49 Stat. 620). Under section 3121(x), if any amount as adjusted under section 215(a)(1)(B)(ii) is not a multiple of $100, such amount is rounded to the next lowest multiple of $100. For calendar year 2005, the applicable dollar threshold is $1,400.

Section 3121(i)(1) provides that in the case of domestic service described in section 3121(a)(7)(B), any payment of cash remuneration for such service which is more or less than a whole-dollar amount, to the extent prescribed by regulations, may be computed to the nearest dollar. The amendment to section 3121(a)(7)(B) made by the SSDERA requires changes to the regulations under §31.3121(i)–1.

Agricultural Labor

Section 3121(a)(8)(B) provides an exclusion from wages for FICA tax purposes of certain cash remuneration paid by an employer in any calendar year to an employee for agricultural labor. The 1987 Act and 1988 Act amended section 3121(a)(8)(B) to change the test for determining whether cash remuneration paid by an employer to an employee for such service is wages for FICA tax purposes.

Prior to the 1987 Act, section 3121(a)(8)(B) provided that cash remuneration paid by an employer in any calendar year to an employee for agricultural labor was excluded from wages for FICA tax purposes unless the cash remuneration was $150 or more, or the employee performed agricultural labor for the employer on 20 or more days during such year for cash remuneration computed on a time basis. The 1987 Act amended section 3121(a)(8)(B) to provide that cash remuneration paid by an employer in any calendar year to an employee for agricultural labor is excluded from wages for FICA tax purposes unless the cash remuneration paid in such year by the employer to the employee for such labor is $150 or more, or the employer's expenditures for agricultural labor in such year equals or exceeds $2,500.

The 1988 Act added language to 3121(a)(8)(B) to provide that the test of whether the employer's expenditures for agricultural labor in any calendar year equal or exceed $2,500 has no effect in de-

termining whether remuneration paid to an employee in such year constitutes wages under this section if such employee 1) is employed in agriculture as a hand-harvest laborer and is paid on a piece rate basis in an operation which has been, and is customarily and generally recognized as having been, paid on a piece rate basis in the region of employment, 2) commutes daily from his permanent residence to the farm on which he is employed, and 3) has been employed in agriculture less than 13 weeks during the preceding calendar year. Nonetheless, amounts paid to these seasonal workers count towards the $2,500 test when applying section 3121(a)(8)(B) to other agricultural workers. The 1987 and 1988 Acts are effective for cash remuneration paid after December 31, 1987.

Home Workers

Section 3121(a)(10) provides an exclusion from wages for FICA tax purposes of certain cash remuneration paid by an employer to an employee for service described in section 3121(d)(3)(C) (relating to home workers). The 1977 Act amended the dollar threshold amount and time period used to determine the exclusion under section 3121(a)(10).

Prior to the 1977 Act, section 3121(a)(10) provided that cash remuneration paid by an employer in any calendar quarter to an employee for service described in 3121(d)(3)(C) (relating to home workers) was excluded from wages for FICA tax purposes if the cash remuneration paid in such quarter by the employer to the employee for such service was less than $50. The 1977 Act amended section 3121(a)(10) to provide that remuneration paid by an employer in any calendar year to an employee for service described in section 3121(d)(3)(C) (relating to home workers) is excluded from wages for FICA tax purposes if the cash remuneration paid in such year by the employer to the employee for such service is less than $100. The 1977 Act is effective for cash remuneration paid after December 31, 1977.

Service Not in the Course of the Employer's Trade or Business

Section 3121(a)(7)(C) provides an exclusion from wages for FICA tax purposes of certain cash remuneration paid by an employer to an employee for service not in the course of the employer's trade or business. The 1977 Act amended the dollar threshold amount and time period used to determine the exclusion under section 3121(a)(7)(C).

Prior to the 1977 Act, section 3121(a)(7)(C) provided that cash remuneration paid by an employer in any calendar quarter to an employee for service not in the course of the employer's trade or business was excluded from wages for FICA tax purposes if the cash remuneration paid in such quarter by the employer to the employee for such service was less than $50. The 1977 Act amended section 3121(a)(7)(C) to provide that cash remuneration paid by an employer in any calendar year to an employee for service not in the course of the employer's trade or business is excluded from wages for FICA tax purposes if the cash remuneration paid in such year by the employer to the employee for such service is less than $100. The 1977 Act is effective for cash remuneration paid after December 31, 1977.

Explanation of Provisions

These proposed regulations would amend the existing regulations to reflect current law.

The proposed regulations relating to domestic service in a private home of the employer would amend existing regulations §§31.3102–1, 31.3121(a)–2(c), and 31.3121(a)(7)–1 to reflect changes implemented by the SSDERA and to be applicable as of that date. For cash remuneration paid prior to January 1, 1994 (the effective date of the SSDERA), taxpayers should rely on the regulations applicable at the time such cash remuneration was paid.

The proposed regulations relating to agricultural labor would amend existing regulations §§31.3102–1, 31.3121(a)–2(c) and 31.3121(a)(8)–1 to reflect changes implemented by the SSPA, the 1987 Act and the 1988 Act and to be applicable as of that date. For cash remuneration paid prior to January 1, 1988 (the effective date of the 1987 Act and the 1988 Act), taxpayers should rely on the regulations applicable at the time such cash remuneration was paid.

The proposed regulations relating to home workers and/or to service not in the course of the employer's trade or business would amend existing regulations §§31.3102–1, 31.3121(a)–2(c), 31.3121(a)(7)–1 and 31.3121(a)(10)–1 to reflect changes implemented by the 1977 Act and to be applicable as of that date. For cash remuneration paid prior to January 1, 1978 (the effective date of the 1977 Act), taxpayers should rely on the regulations applicable at the time such cash remuneration was paid.

The proposed regulations relating to computation to the nearest dollar of cash remuneration for domestic service would amend the existing regulations under §31.3121(i)–1 to reflect changes implemented by the SSDERA and to be applicable as of that date. For cash remuneration paid prior to January 1, 1994 (the effective date of the SSDERA), taxpayers should rely on the regulations applicable at the time such cash remuneration was paid.

Proposed Effective Date

These proposed regulations would be applicable on the date of publication of the Treasury Decision adopting these regulations as final regulations in the **Federal Register**. The regulations relating to domestic service in a private home of the employer would apply to cash remuneration paid on or after January 1, 1994. The regulations relating to agricultural labor would apply to cash remuneration paid on or after January 1, 1988. The regulations relating to home workers and/or service not in the course of the employer's trade or business would apply to cash remuneration paid on or after January 1, 1978. The regulations relating to computation to the nearest dollar of cash remuneration for domestic service would apply to cash remuneration paid on or after January 1, 1994.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to these regulations, and therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Code, this

notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The IRS and Treasury Department specifically request comments on the clarity of proposed regulations and how they can be made easier to understand. All comments will be available for public inspection and copying. A public hearing may be scheduled if requested by any person who timely submits comments. If a public hearing is scheduled, notice of the date, time and place for the hearing will be published in the **Federal Register**.

Drafting Information

The principal authors of these proposed regulations are Paul J. Carlino and Michael A. Swim, Office of the Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 31 is proposed to be amended as follows:

PART 31—EMPLOYMENT TAXES AND COLLECTION OF INCOME TAX AT SOURCE

Paragraph 1. The authority citation for part 31 continues to read, in part, as follows:

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

Par. 2. Section 31.3102–1 is amended by:

1. Revising paragraph (b).
2. Redesignating paragraph (c) as paragraph (d).
3. Adding new paragraph (c).
4. Adding paragraph (e).

The additions and revision read as follows:

§31.3102–1 Collection of, and liability for, employee tax; in general.

* * * * *

(b) The employer is permitted, but not required, to deduct amounts equivalent to employee tax from payments to an employee of cash remuneration to which the sections referred to in this paragraph (b) are applicable prior to the time that the sum of such payments equals—

(1) $100 in the calendar year, for service not in the course of the employer's trade or business, to which §31.3121(a)(7)–1 is applicable;

(2) The applicable dollar threshold (as defined in section 3121(x)) in the calendar year, for domestic service in a private home of the employer, to which §31.3121(a)(7)–1 is applicable;

(3) $150 in the calendar year, for agricultural labor, to which §31.3121(a)(8)–1(c)(1)(i) is applicable; or

(4) $100 in the calendar year, for service performed as a home worker, to which §31.3121(a)(10)–1 is applicable.

(c) At such time as the sum of the cash payments in the calendar year for a type of service referred to in paragraph (b)(1), (b)(2), (b)(3) or (b)(4) of this section equals or exceeds the amount specified, the employer is required to collect from the employee any amount of employee tax not previously deducted. If an employer pays cash remuneration to an employee for two or more of the types of service referred to in paragraph (b)(1), (b)(2), (b)(3) or (b)(4) of this section, the provisions of paragraph (b) of this section and this paragraph (c) are to be applied separately to the amount of remuneration attributable to each type of service. For provisions relating to the repayment to an employee, or other disposition, of amounts deducted from an employee's remuneration in excess of the correct amount of employee tax, see §31.6413(a)–1.

* * * * *

(e)(1) The provisions of paragraphs (a) and (d) of this section apply to any payment made on or after January 1, 1955.

(2) The provisions of paragraphs (b) and (c) of this section that apply to any payment made for service not in the course of the employer's trade or business or for service performed as a home worker within the meaning of section 3121(d)(3)(C) apply to any such payment made on or after January 1, 1978. The provisions of paragraphs (b) and (c) of this section that apply to any payment made for domestic service in a private home of the employer apply to any such payment made on or after January 1, 1994. The provisions of paragraphs (b) and (c) of this section that apply to any payment made for agricultural labor apply to any such payment made on or after January 1, 1988. For rules applicable to any payment for these services made prior to the dates set forth in this paragraph (e)(2), see §31.3102–1 in effect at such time (see 26 CFR part 31 revised as of April 1, 2005).

Par. 3. Section 31.3121(a)–2 is amended by:

1. Revising paragraph (c)(1).
2. Redesignating paragraphs (c)(2) and (c)(3) as paragraphs (c)(3) and (c)(4), respectively.
3. Adding new paragraph (c)(2).
4. Revising newly designated paragraph (c)(3).
5. Adding paragraph (d).

The additions and revisions read as follows:

§31.3121(a)–2 Wages; when paid and received.

* * * * *

(c)(1) The first $100 of cash remuneration paid, either actually or constructively, by an employer in any calendar year to an employee for—

(i) Service not in the course of the employer's trade or business, to which §31.3121(a)(7)–1 is applicable, shall be deemed to be paid by the employer to the employee at the first moment of time in such calendar year that the sum of such cash payments made within such year is at least $100; or

(ii) Service performed as a home worker within the meaning of section 3121(d)(3)(C), to which §31.3121(a)(10)–1 is applicable, shall be deemed to be paid by the employer to the employee at the first moment of time in such calendar year that the sum of such cash payments made within such year is at least $100.

(2) Cash remuneration paid, either actually or constructively, by an employer in any calendar year to an employee for domestic service in a private home of the employer to which §31.3121(a)(7)–1 is applicable, and before the sum of the payments of such cash remuneration equals or exceeds the applicable dollar threshold (as defined in section 3121(x)) for such year, shall be deemed to be paid by the employer to the employee at the first moment of time in such calendar year that the sum of such cash payments made within such year equals or exceeds the applicable dollar threshold (as defined in section 3121(x)) for such year.

(3) Cash remuneration paid, either actually or constructively, by an employer in any calendar year to an employee for agricultural labor to which §31.3121(a)(8)–1 is applicable, and before either of the events described in paragraphs (c)(3)(i) and (c)(3)(ii) of this section has occurred, shall be deemed to be paid by the employer to the employee at the first moment of time in such calendar year that—

(i) The sum of the payments of such remuneration is $150 or more; or

(ii) The employer's expenditures for agricultural labor in such calendar year equals or exceeds $2,500, except that this paragraph (c)(3)(ii) shall not apply in determining when such remuneration is deemed to be paid under this paragraph if such employee—

(A) Is employed as a hand-harvest laborer and is paid on a piece rate basis in an operation which has been, and is customarily and generally recognized as having been, paid on a piece rate basis in the region of employment;

(B) Commutes daily from his permanent residence to the farm on which he is so employed; and

(C) Has been employed in agriculture less than 13 weeks during the preceding calendar year.

* * * * *

(d)(1) The provisions of paragraphs (a) and (b) of this section apply to any payment of wages made on or after January 1, 1955.

(2) The provisions of paragraph (c) of this section that apply to any payment of wages made for service not in the course of the employer's trade or business or for service performed as a home worker within the meaning of section 3121(d)(3)(C) apply to any such payment made on or after January 1, 1978. The provisions of paragraph (c) of this section that apply to any payment of wages made for domestic service in a private home of the employer apply to any such payment made on or after January 1, 1994. The provisions of paragraph (c) of this section that apply to any payment of wages made for agricultural labor apply to any such payment made on or after January 1, 1988. For rules applicable to any payment of wages for these services made prior to the dates set forth in this paragraph (d)(2), see §31.3121(a)–2 in effect at such time (see 26 CFR part 31 revised as of April 1, 2005).

Par. 4. Section 31.3121(a)(7)–1 is amended by:

1. Revising paragraphs (c)(1) and (c)(2).

2. Adding paragraphs (c)(3), (d) and (e).

The additions and revisions read as follows:

§31.3121(a)(7)–1 Payments for services not in the course of employer's trade or business or for domestic service.

* * * * *

(c) *Cash payments*. (1) The term *wages* does not include cash remuneration paid by an employer in any calendar year to an employee for—

(i) Domestic service in a private home of the employer, unless the cash remuneration paid in such year by the employer to the employee for such service equals or exceeds the applicable dollar threshold (as defined in section 3121(x)) for such year; or

(ii) Service not in the course of the employer's trade or business, unless the cash remuneration paid in such year by the employer to the employee for such service equals or exceeds $100.

(2) The tests relating to cash remuneration are based on the remuneration paid in a calendar year rather than on the remuneration earned during a calendar year. The following example illustrates this provision:

Example. On March 31, 2004, employer X pays employee A cash remuneration of $100 for service not in the course of X's trade or business. Such remuneration constitutes wages subject to the taxes even though $10 thereof represents payment for such service performed by A for X in December 2003.

(3) In determining whether wages have been paid either for domestic service in a private home of the employer or for service not in the course of the employer's trade or business, only cash remuneration for such service shall be taken into account. Cash remuneration includes checks and other monetary media of exchange. Remuneration paid in any other medium, such as lodging, food, clothing, car tokens, transportation passes or tickets, or other goods or commodities, is disregarded in determining whether the cash-remuneration test is met. If an employee receives cash remuneration from an employer in a calendar year for both types of services the pertinent cash-remuneration test is to be applied separately to each type of service. If an employee receives cash remuneration from more than one employer in a calendar year for domestic service in a private home of the employer or for service not in the course of the employer's trade or business, the pertinent cash-remuneration test is to be applied separately to the remuneration received from each employer.

(d) *Cross references*. (1) For provisions relating to deduction of employee tax or amounts equivalent to the tax from cash payments for the services described in this section, see §31.3102–1;

(2) For provisions relating to time of payment of wages for such services, see §31.3121(a)–2;

(3) For provisions relating to computations to the nearest dollar of any payment of cash remuneration for domestic service in a private home of the employer, see §31.3121(i)–1.

(e) *Effective dates*. (1) The provisions of this section apply to any cash payment for service not in the course of the employer's trade or business made on or after January 1, 1978 and for domestic service in a private home of the employer made on or after January 1, 1994.

(2) For rules applicable to any cash payment made prior to the dates set forth in paragraph (e)(1), see §31.3121(a)(7)–1 in effect at such time (see 26 CFR part 31 revised as of April 1, 2005).

Par. 5. Section 31.3121(a)(8)–1 is amended by:

1. Revising paragraphs (c), (d), and (e).

2. Adding paragraph (h).

The addition and revisions read as follows:

§31.3121(a)(8)–1 Payments for agricultural labor.

* * * * *

(c) *Cash payments*. (1) The term *wages* does not include cash remuneration paid by an employer in any calendar year to an employee for agricultural labor unless—

(i) The cash remuneration paid in such year by the employer to the employee for such labor is $150 or more; or

(ii) The employer's expenditures for agricultural labor in such year equal or exceed $2,500, except that this paragraph (c)(1)(ii) shall not apply in determining whether remuneration paid to an employee constitutes wages for agricultural labor if such employee—

(A) Is employed as a hand-harvest laborer and is paid on a piece rate basis in an operation which has been, and is customarily and generally recognized as having been, paid on a piece rate basis in the region of employment;

(B) Commutes daily from his permanent residence to the farm on which he is so employed; and

(C) Has been employed in agriculture less than 13 weeks during the preceding calendar year.

(2) The application of the provisions of paragraph (c)(1) of this section may be illustrated by the following example:

Example. Employer X pays A $140 in cash for agricultural labor in calendar year 2004. X makes no other payments to A during the year and makes no other payment for agricultural labor to any other employee. Employee A is not employed as a hand-harvest laborer. Neither the $150-cash-remuneration test nor the $2,500-employer's-expenditures-for-agricultural-labor test is met. Accordingly, the remuneration paid by X to A is not subject to the taxes. If in 2004 X had paid A $140 in cash for agricultural labor and had made expenditures of $2,360 or more to other employees for agricultural labor, the $140 paid by X to A would have been subject to tax because the $2,500-employer's-expenditures-for-agricultural-labor test would have been met. Or, if X had paid A $150 in cash in 2004 and made no other payments to any other employee for agricultural labor, the $150 paid by X to A would have been subject to tax because the $150-cash-remuneration test would have been met.

(d) *Application of cash-remuneration test*. (1) If an employee receives cash remuneration from an employer both for services which constitute agricultural labor and for services which do not constitute agricultural labor, only the amount of such remuneration which is attributable to agricultural labor shall be included in determining whether cash remuneration of $150 or more has been paid in the calendar year by the employer to the employee for agricultural labor. The following example illustrates this paragraph (d)(1):

Example. Employer X operates a store and also is engaged in farming operations. Employee A, who regularly performs services for X in connection with the operation of the store, works on X's farm when additional help is required for the farm activities. In the calendar year 2004, X pays A $140 in cash for services performed in agricultural labor, and $4,000 for services performed in connection with the operation of the store. X has no additional expenditures for agricultural labor in 2004. Since the cash remuneration paid by X to A in the calendar year 2004 for agricultural labor is less than $150, the $150-cash-remuneration test is not met. The $140 paid by X to A in 2004 for agricultural labor does not constitute wages and is not subject to the taxes.

(2) The test relating to cash remuneration of $150 or more is based on the cash remuneration paid in a calendar year rather than on the remuneration earned during a calendar year. It is immaterial if such cash remuneration is paid in a calendar year other than the year in which the agricultural labor is performed. The following example illustrates this paragraph (d)(2):

Example. Employer X pays cash remuneration of $150 in the calendar year 2004 to employee A for agricultural labor. Such remuneration constitutes wages even though $10 of such amount represents payment for agricultural labor performed by A for X in December 2003.

(3) In determining whether $150 or more has been paid to an employee for agricultural labor, only cash remuneration for such labor shall be taken into account. If an employee receives cash remuneration in any one calendar year from more than one employer for agricultural labor, the cash-remuneration test is to be applied with respect to the remuneration received by the employee from each employer in such calendar year for such labor.

(e) *Application of employer's-expenditures-for-agricultural-labor test*. (1) If an employer has expenditures in a calendar year for agricultural labor and for non-agricultural labor, only the amount of such expenditures for agricultural labor shall be included in determining whether the employer's expenditures for agricultural labor in such year equal or exceed $2,500. The following example illustrates this paragraph (e)(1):

Example. Employer X operates a store and also is engaged in farming operations. Employee A, who regularly performs services for X in connection with the operation of the store, works on X's farm when additional help is required for the farm activities. In calendar year 2004, X pays A $140 in cash for services performed in agricultural labor, and $4,000 for services performed in connection with the operation of the store. X has no additional expenditures for agricultural labor in 2004. Since X's expenditures for agricultural labor in 2004 are less than $2,500, the employer's-expenditures-for-agricultural-labor test is not met. The $140 paid by X to A in 2004 for agricultural labor does not constitute wages and is not subject to the taxes.

(2) The test relating to an employer's expenditures of $2,500 or more for agricultural labor is based on the expenditures paid by the employer in a calendar year rather than on the expenses incurred by the employer during a calendar year. It is immaterial if the expenditures are paid in a calendar year other than the year in which the agricultural labor is performed. The following example illustrates this paragraph (e)(2):

Example. Employer X employs A to construct fences on a farm owned by X. The work constitutes agricultural labor and is performed over the course of November and December 2003. A is not employed by X at any other time, however X does have other employees to whom X pays remuneration of $2,000 for agricultural labor in 2003. X pays A $140 in cash in November 2003 and $140 in cash in January 2004, in full payment for the work. The $140 payment to A made in November is not wages for calendar year 2003 because the $150-cash-remuneration test is not met and X's total expenditures for agricultural labor for such year are not equal to or in excess of $2,500. The $140 payment to A made in January is not wages for 2004 because the $150 cash-remuneration test is not met. However, if X pays additional remuneration to employees for agricultural labor in 2004 that equals or exceeds $2,360, the employer's-expenditures-for-agricultural-labor test will be met and the $140 paid by X to A in 2004 will be considered wages. It is immaterial that the work was performed in 2003.

* * * * *

(h) *Effective dates*. The provisions of this section apply to any payment for agricultural labor made on or after January 1, 1988. For rules applicable to any payment for agricultural labor made prior to January 1, 1988, see §31.3121(a)(8)–1 in effect at such time (see 26 CFR part 31 revised as of April 1, 2005).

Par. 6. Section 31.3121(a)(10)–1 is revised to read as follows:

§31.3121(a)(10)–1 Payments to certain home workers.

(a) The term *wages* does not include remuneration paid by an employer in any calendar year to an employee for service performed as a home worker who is an employee by reason of the provisions of section 3121(d)(3)(C) (see

§31.3121(d)–1(d)), unless the cash remuneration paid in such calendar year by the employer to the employee for such services is $100 or more. The test relating to cash remuneration of $100 or more is based on remuneration paid in a calendar year rather than on remuneration earned during a calendar year. If cash remuneration of $100 or more is paid in a particular calendar year, it is immaterial whether such remuneration is in payment for services performed during the year of payment or during any other year.

(b) The application of paragraph (a) of this section may be illustrated by the following example:

Example. A, a home worker, performs services for X, a manufacturer, in 2003 and 2004. In the performance of the home work A is an employee by reason of section 3121(d)(3)(C). In March 2004, A returns to X articles made by A at home from materials received by A from X in 2003. X pays A cash remuneration of $100 for such work when the finished articles are delivered. The $100 includes $10 which represents remuneration for home work performed by A in 2003. The entire $100 is subject to the taxes. Any additional cash remuneration paid by X to A in 2004 for such services is also subject to the taxes.

(c) In the event an employee receives remuneration in any one calendar year from more than one employer for services performed as a home worker of the character described in paragraph (a) of this section, the regulations in this section are to be applied with respect to the remuneration received by the employee from each employer in such calendar year for such services. This exclusion from wages has no application to remuneration paid for services performed as a home worker who is an employee under section 3121(d)(2) (see §31.3121(d)–1(c)) relating to common law employees.

(d) Cash remuneration includes checks and other monetary media of exchange. Remuneration paid in any other medium, such as clothing, car tokens, transportation passes or tickets, or other goods or commodities, is disregarded in determining whether the $100 cash-remuneration test is met. If the cash remuneration paid in any calendar year by an employer to an employee for services performed as a home worker of the character described in paragraph (a) of this section is $100 or more, then no remuneration, whether in cash or in any medium other than cash, paid by the employer to the employee in such calendar year for such services is excluded from wages under this exception.

(e)(1) For provisions relating to deductions of employee tax or amounts equivalent to the tax from cash payments for services performed as a home worker within the meaning of section 3121(d)(3)(C), see §31.3102–1.

(2) For provisions relating to the time of payment of wages for services performed as a home worker within the meaning of section 3121(d)(3)(C), see §31.3121(a)–2.

(3) For provisions relating to records to be kept with respect to payment of wages for services performed as a home worker within the meaning of section 3121(d)(3)(C), see §31.6001–2.

(f) The provisions of this section apply to any payment for services performed as a home worker within the meaning of section 3121(d)(3)(C) made on or after January 1, 1978. For rules applicable to any payment for services performed as a home worker within the meaning of section 3121(d)(3)(C) made prior to January 1, 1978, see §31.3121(a)(10)–1 in effect at such time (see 26 CFR part 31 revised as of April 1, 2005).

Par. 7. Section 31.3121(i)–1 is amended as follows:

1. Redesignating the undesignated text as paragraph (a).

2. Remove the language "quarter" each place it appears and add "year" in its place in newly designated paragraph (a).

3. Adding new paragraph (b).

The addition reads as follows:

§31.3121(i)–1 Computation to nearest dollar of cash remuneration for domestic service.

* * * * *

(b) The provisions of this section apply to any cash payment for domestic service in a private home of the employer made on or after January 1, 1994. For rules applicable to any cash payment for domestic service in a private home of the employer made prior to January 1, 1994, see §31.3121(i)–1 in effect at such time (see 26 CFR part 31 revised as of April 1, 2005).

Mark E. Matthews,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on August 25, 2005, 8:45 a.m., and published in the issue of the Federal Register for August 26, 2005, 70 F.R. 50228)

Optional Standard Mileage Rates

Announcement 2005–71

This announcement informs taxpayers that the Internal Revenue Service is modifying Rev. Proc. 2004–64, 2004–49 I.R.B. 898, by revising the optional standard mileage rates for computing the deductible costs of operating an automobile for business, medical, or moving expense purposes and for determining the reimbursed amount of these expenses that is deemed substantiated. This modification results from recent increases in the price of fuel.

The revised standard mileage rates are:

	(1) Business	48.5 cents per mile
	(2) Medical and moving	22 cents per mile

The mileage rate that applies to the deduction for charitable contributions is fixed under § 170(i) of the Internal Revenue Code at 14 cents per mile.

The revised standard mileage rates set forth in this announcement apply to deductible transportation expenses paid or incurred for business, medical, or moving expense purposes on or after September 1, 2005, and to mileage allowances that are paid both (1) to an employee on or after September 1, 2005, and (2) with respect to transportation expenses paid or incurred by the employee on or after September 1, 2005.

The standard mileage rates set forth in Rev. Proc. 2004–64 continue to apply to deductible transportation expenses paid

or incurred for business, medical, or moving expense purposes before September 1, 2005, and to mileage allowances paid both (1) to an employee before September 1, 2005, and (2) with respect to transportation expenses paid or incurred by the employee before September 1, 2005. All other provisions of Rev. Proc. 2004–64 remain in effect.

EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2004–64 is modified.

DRAFTING INFORMATION

The principal author of this announcement is John Roman Faron of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this announcement, contact Mr. Faron at (202) 622–4930 (not a toll-free call).

Updated Information for Publication 1187, *Specifications for Filing Form 1042-S, Foreign Person's U.S. Source Income Subject to Withholding, Electronically or Magnetically*

Announcement 2005–73

This announcement provides updated information to Publication 1187, *Specifications for Filing Form 1042-S, Foreign Person's U.S. Source Income Subject to Withholding, Electronically or Magnetically*. This information is general in nature. There are no legislative or format changes. Information provided in Rev. Proc. 2004–63, 2004–45 I.R.B. 795 (dated November 8, 2004), is still valid with the exception of the following items:

1. The Martinsburg Computing Center was renamed the Enterprise Computing Center-Martinsburg (ECC-MTB).

2. IRS/ECC-MTB now offers an Internet connection at *http://fire.irs.gov* for electronic filing. The FIRE System will be down from December 23, 2005, through January 3, 2006, for upgrading. It is not operational during this time for submissions.

3. Beginning in Tax Year 2006, processing year 2007, IRS/ECC-MTB will no longer accept 3½-inch diskettes for filing 1042-S information returns.

4. Additional special characters were added (*e.g.*, period, apostrophe, pound sign and forward slash). The special characters can be used in the "W" record, fields 14–133 Withholding Agent's Name Line 1–3; fields 134–213 Withholding Agent's Street Line 1 & 2; "Q" record, fields 94–213 Recipient's Name Line 1–3; and, fields 214–293 Recipient's Street Line 1 & 2.

5. IRS/ECC-MTB strongly encourages all electronic or magnetic media filers to submit a test. Testing dates will be November 1, 2005 through December 15, 2005.

6. The following change was made to the Withholding Agent "W" Record, field position 13, field title Withholding Agent's EIN Indicator:

   a. Note: Use EIN indicator **1** only if the Withholding Agent's EIN begins with "98" *and* the Withholding Agent's City, State and Country Code fields indicate that the Withholding Agent is *not* a U.S. Withholding Agent.

Publication 1187 is available through the IRS Website *www.irs.gov*.

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.

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