

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

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

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

### TD 9672

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

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

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

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

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

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

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

SUPPLEMENTARY INFORMATION:

#### Background

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

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

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

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

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

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

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

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

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

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

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

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

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

## Explanation and Summary of Comments

### I. In general

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

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

### II. Eligibility for the Credit

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

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

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

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

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

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

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

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

### III. *Calculating the Credit*

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

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

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

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

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

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

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

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

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

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

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

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

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

Several commenters requested the credit be made available to eligible small

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

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

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

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

### III. Application of Uniform Percentage Requirement

#### A. Uniform premium

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

#### B. Composite billing and list billing

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

#### C. Employers offering one QHP

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

#### *IV. Claiming the Credit*

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

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

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

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

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

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

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

#### **Special Analyses**

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

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

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

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

#### **Drafting Information**

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

\* \* \* \* \*

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

Accordingly, 26 CFR part 1 is amended as follows:

#### **PART I—INCOME TAXES**

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

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

#### *§ 1.45R-0 Table of contents*

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

#### *§ 1.45R-1 Definitions*

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

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

§ 1.45R-2 Eligibility for the credit.

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

§ 1.45R-3 Calculating the credit.

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

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

§ 1.45R-4 Uniform percentage of premium paid.

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

§ 1.45R-5 Claiming the credit.

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

- (d) Effective/applicability date.

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

§ 1.45R-1 Definitions.

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

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

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

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

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

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



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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

### § 1.45R-3 Calculating the credit.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

comply with an applicable State or local law.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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



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

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

#### § 1.45R-5 Claiming the credit.

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

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

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

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

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

John Dalrymple  
Deputy Commissioner  
for Services and Enforcement.

Approved June 24, 2014,

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

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

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

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

TD 9673

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

#### Longevity Annuity Contracts

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

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

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

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

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

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

SUPPLEMENTARY INFORMATION:

#### Paperwork Reduction Act

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

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