
AMERICAN BAR ASSOCIATION

SECTION OF TAXATION

MAY MEETING 2015

COMMITTEE ON EMPLOYEE BENEFITS

JOINT COMMITTEE ON EMPLOYEE BENEFITS

INTERNAL REVENUE SERVICE

MAY 8, 2015

The following questions and answers are based on an oral presentation made by IRS and Treasury officials at the Tax Section's Employee Benefits Committee meeting on May 8, 2015. The statements contained herein cannot be relied on even though they are printed as statements of the IRS. The questions were submitted by ABA members, and the responses were given at such meeting after explicit statements that their responses reflect the unofficial, individual views of the government participants as of the time of the discussion, and do not necessarily represent agency policy. This report on the responses was prepared by designated JCEB representatives, based on the notes and recollections of the JCEB representatives at the meeting and on a review of audio tapes of the meeting. This report has not been reviewed by IRS or Treasury. The questions were submitted in advance to the agency, and it was understood that this report would be made available to the public.

1. § 72(p) – Extension of Loan Repayment Period for Non-Military Leave

A participant takes out a 3 year loan under the plan in January 2014. The term of the loan ends in December 2016. In January 2015, she takes a non-military leave of absence without a pay for 6 months. Her loan is suspended during this 6 month period. Can the plan allow her to repay the loan by June 2017?

Proposed Response: Yes. Treasury Regulation Section 1.72(p)-1, Q-A-9 requires that the loan “must be repaid by the latest permissible term of the loan” and the latest permissible term of the loan under the Code is five years from the date of the loan. As long as the loan is repaid within 5 years from the date of the loan, the plan can allow the participant who takes a leave of absence to extend the term of the loan.

IRS Response: The Service representative agrees with the proposed response. Treasury Regulation Section 1.72(p)-1, Q&A 9 has a discussion of these leaves of absence. There also are some FAQs on the IRS website that talk about some of these loan issues at: <http://www.irs.gov/Retirement-Plans/Retirement-Plans-FAQs-regarding-Loans>. The Service representative noted a few more details about the limitations on the ability to extend the period of the loan. First, the leave of absence that has the extended loan period cannot be more than a year, which is indicated in the regulations. Second, the amount that is paid cannot go down as a result of the extension of the leave of absence – and/or the extension of the loan period. Finally, the term of the loan cannot go beyond the initial limitation on how long the loan could be for. So, if the general limitation is five years for a period of a loan, the unpaid leave of absence, non-military leave of absence could not take the period beyond the five years that would have initially applied.

2. § 72(p) – Plan Loans

A participant who took out a loan from a Section 401(k) plan fails to make timely payment of the loan (after the cure period). As a result, a deemed distribution occurs in April due to a loan default and later in the same calendar year in November a loan offset occurs because the defaulted participant later reached age 59½ in November which is a distribution event under the plan. At the time the participant defaulted on the loan, no exception to the Code Section 72(t) early distribution penalty was available to him. Does the plan administrator who issues Form 1099-R still indicate that the distribution was a deemed distribution (Code L in box 7 of Form 1099-R) and an early distribution (Code 1) even if there is a loan offset and the participant is over 59½ by the time the plan administrator issues the Form 1099-R?

Proposed Response: Yes. Once the participant defaults on the loan, the loan is considered a deemed distribution regardless of whether a loan offset occurs later in the same calendar year.

IRS Response: The Service representative agrees with the proposed response. The Service representative stated that it does not matter that the Form 1099-R has not yet been issued at the time the individual turns 59½ as the general rules would apply.

3. § 162(m) – Performance-Based Pay

A performance-based compensation plan that meets certain requirements is exempt from the \$1 million deduction limit under Section 162(m). Treasury Regulation § 1.162-27(e)(4)(i)-(v) provides that performance-based compensation does not qualify for exclusion from the Section 162(m) deduction limitation unless the material terms of the plan are disclosed to and approved by shareholders before the compensation is paid. These include eligible employees, the business criteria on which performance goals may be based and either the maximum amount payable or the formula used to calculate awards. The shareholder approval requirement for purposes of Section 162(m) is not satisfied if the compensation would be paid regardless of whether the material terms are approved by shareholders.

We seek the IRS viewpoint on Company A's ability to utilize the performance-based exception under Section 162(m) under the following factual situations:

Question A: Company A maintains an Omnibus Plan that specifies that no executive shall receive options for more than 100,000 shares of Company A stock during any calendar year. The Company A Omnibus Plan was approved by shareholders in 2014. In February of 2015, Company A's Compensation Committee granted 95,000 options to its CEO. Later in 2015, the Compensation Committee made a one-time grant to the CEO of 10,000 options, which inadvertently caused the number of options granted to exceed the maximum 100,000 option annual limit previously approved by shareholders. Assume that this error is not discovered until after the close of the 2015 calendar year.

Question B: Assume the same facts as in Question A, except that Company A agrees with the CEO to rescind the grant of 10,000 before the close of the 2015 calendar year.

Question C: Company B maintains an Omnibus Plan that specifies that no more than 500,000 options can be granted under the plan. The Company B Omnibus Plan was approved by shareholders in 2012. In February of 2013, Company B's Compensation Committee granted executives 200,000 options that will cliff vest on the last day of 2015. In February of 2014, Company B's Compensation Committee granted executives 200,000 options that will cliff vest on the last day of 2016. In February of 2015, Company B's Compensation Committee granted executives 200,000 options that will cliff vest on the last day of 2017, which inadvertently caused the number of options granted to exceed the maximum 500,000 option grant limit previously approved by shareholders. Assume that this error is not discovered until after the close of the 2015 calendar year.

Question D: Assume the same facts as in Question C, except that in February of 2015, Company B's Compensation Committee granted executives 100,000 options that will cliff vest on the last day of 2017. In April of 2015, Company B makes an inducement grant to a new CEO of 50,000 options that will cliff vest on the last day of 2017. Company B is listed on the New York Stock Exchange.

Proposed Response A: Since the one-time grant of 10,000 options to the CEO would cause the number of option grants for an individual to exceed the annual limit, only the 5,000 options granted in excess of that limit would not be eligible under the performance-based exception when exercised.

Proposed Response B: Since the one-time grant of 10,000 options was rescinded before the end of the year in which the option grant limit was exceeded, the remaining 95,000 options would continue to meet the performance-based exception when exercised.

Proposed Response C: Because the February, 2015 option grant exceeded the plan limit by 100,000 shares, those options would no longer be eligible under the performance-based exception when exercised.

Proposed Response D: Despite the fact that inducement grants need not be approved by shareholders under NYSE rules, such grants are still subject to the shareholder approval requirements of Treasury Regulation § 1.162-27(e)(4)(i)-(v). However, only the 50,000 options granted to the CEO during 2015 year are not eligible under the performance-based exception when exercised.

IRS Response C: The Service representative agrees with Proposed Response C and noted that the same concepts apply to the other parts of this question. Ordinarily, performance-based compensation is looked at on a grant-by-grant basis, so it is all or nothing. Either the grant fails or the grant is considered performance-based compensation. But, in the case of stock-based compensation and options granted pursuant to that, only the option numbers that exceed the authorized number (\$500,000) would fail to be performance based compensation under the Section 162(m) rules. The Service representative mentioned

that the fact pattern did not mention whether the plan has an individual employee limit in a time period over which the options may be granted. The Service representative pointed out that it just issued final regulations to clarify that the plan has to have an individual employee limit and that the rule has always been that the option plan has to set forth the time period over which the options may be granted.

4. § 401(a) – Correction of Plan Failure – Employee Matching Percentage

Assume a Section 401(k) Plan provides for a matching contribution of 1% of compensation, but only if the participant defers 4% of compensation. An employee was inadvertently excluded from the Plan. The average deferral percentage for the employee's group was 3.8%. In this instance, the employer will make a corrective contribution equal to the compensation for the period of the exclusion x 3.8% x 50%. This amount also will be adjusted for earnings. Is the employer also required to make a matching contribution?

Proposed Response: No. The average deferral percentage for the group was 3.8%. Under the terms of the Plan, no match is due unless an employee contributes 4%.

IRS Response: The Service representative agrees with the proposed response. The Service representative indicated that there is no matching contribution required in this case, and referred to Appendix B in Rev. Proc. 2013-12, Section .02(1)(D).

5. § 401(a) – Form 2848, Power of Attorney for Determination Letter Application

The Instructions to Form 2848 provide specific instruction as to how complete line 3 of Form 2848. Specifically, the third paragraph under the section titled "Line 3. Acts Authorized" on page 3 of the Instructions provide that "If the matter is not a tax matter, or if the tax form number or years or periods do not apply to the matter (for example, representation for a penalty or filing a ruling request or a determination letter..., specifically describe the matter to which the power of attorney pertains (including, if applicable, the name of the employee benefit plan) and enter "Not Applicable" in the appropriate column(s)."

The record keeper has consistently completed the Form 2848 in accordance with these instructions when submitting an application for a determination letter for a qualified retirement plan. Recently, when following up with the IRS at the Tax Forms number, the record keeper has been told that the power of attorney is invalid because Line 3 failed to list a "tax form." On one occasion, a copy of the determination letter was not sent to the person listed on the power of attorney because the IRS did not record that the submission was accompanied by a power of attorney.

How should line 3 of Form 2848 be completed when it is used to accompany a determination letter application for a qualified retirement plan?

Proposed Response: Form 2848 should be completed in accordance with the instructions provided for the Form 2848 as described above. However, to avoid unnecessary problems with the IRS, it is advisable to enter the Form number related to the determination letter submission, Form 5300, 5307 or 5310, as applicable. The tax years do not require completion.

IRS Response: The Service representative stated that to avoid unnecessary problems with the IRS, it is advisable to enter the form number (*i.e.*, the Form 5300, 5307 or 5310) related to the determination letter submission. Additionally, the representative recommended that practitioners put the plan name in, and also include as a description, that it is a determination letter application in the first column. In the second column, put the form number in, 5300, 5307 or 5310. In the third column, put the applicable period for

which the application is made if its cycle filing, *i.e.*, the particular cycle for an ongoing plan. If it is a terminating plan, then you would just indicate not applicable.

6. § 401(a) – Profit Sharing Plan With Target Benefit Design

Company F maintains a profit sharing plan with a 401(k) deferral feature. The plan was adopted in 1990. In 2005, the plan was amended to add an employer nonelective contribution (the “Defined Contribution”). Under the plan’s terms, as amended, the Defined Contribution is to be made annually to the accounts of eligible plan participants (as defined in the plan). The contribution is non-discretionary, and the amount of the contribution is determined under a fixed formula that targets (but does not promise) the accumulation of an account balance at normal retirement age that is designed to be sufficient to purchase an annuity that would pay a targeted monthly retirement benefit. In other words, the Defined Contribution is designed as a target benefit.

The portion of the plan under which the Defined Contribution is offered specifically provides that the contribution will be tested for nondiscrimination using the “general test” provided for in Treasury Regulation Section 1.401(a)(4)-2(c).

Company F designates the Defined Contribution as a profit sharing contribution in the plan document, and designates the plan as a “profit sharing plan” in its annual report filings using Form 5500, and in its periodic determination letter filings using Form 5300.

Notwithstanding Company F’s designation of the Defined Contribution as a profit sharing contribution, does this portion of the plan nevertheless constitute a money purchase pension plan due to the formula used to determine the annual amount of the contribution?

Proposed Response: No.

Analysis: The original Treasury regulations governing tax-qualified plans provided that a money purchase pension plan was a plan providing for employer contributions that “are fixed without being geared to profits.” Treas. Reg. § 1.401-1(b)(1)(i). By contrast, under those regulations a profit sharing plan was a “plan established and maintained by an employer to provide for the participation in his profits by his employees.” Treas. Reg. § 1.401-1(b)(1)(ii). These regulations, dating to the 1950s and 60s, have not been updated to reflect current law.

TRA of 1986, as amended by TAMRA of 1988, eliminated the requirement that a profit sharing contribution be contingent upon the employer’s profits. It also added the requirement that an employer designate a defined contribution plan as a profit sharing plan or a money purchase pension plan, using such means as the Secretary of Treasury may prescribe. See Code § 401(a)(27).

Treasury Regulation Section 1.401(a)(4)-8(b)(3)(i) defines a “target benefit plan” as “a money purchase pension plan under which contributions to an employee’s account are determined by reference to the amounts necessary to fund the employee’s stated benefit under the plan.”

Prior to the addition of Section 401(a)(27) to the Internal Revenue Code, a profit sharing plan was distinguished from a money purchase pension plan by its design. Employer contributions to a profit sharing plan were contingent upon the employer earning profits. By contrast, employer contributions to a money purchase plan were non-contingent and the plan’s design typically required them to be made annually.

However, since the addition of Code Section 401(a)(27), it is not possible to identify a money purchase pension plan on the basis of a plan's design. An employer contribution may be a "profit sharing" contribution even if it is not contingent upon the existence of profits and even if it is required under the plan's terms (*i.e.*, is non-discretionary). Congress provided in Section 401(a)(27) that the plan sponsor must designate a plan as either a profit sharing or money purchase plan.

The Treasury Regulation that defines "target benefit plan" for nondiscrimination testing purposes (Treas. Reg. § 1.401(a)(4)-8(b)(3)(i)) does not prohibit a plan sponsor from designating a nonelective employer contribution determined under a target benefit formula as a profit sharing plan. Rather, the regulation requires that a plan sponsor that wishes to use the design based safe-harbor of section 1.401(a)(4)-8(b)(3) must designate such a contribution as a money purchase plan.

In this case, Company F's designation of the Defined Contribution as a "profit sharing" plan is effective, and is permissible because the plan precludes the use of the design based safe-harbor that is available solely to target benefit-type money purchase plans under Treasury Regulation Section 1.401(a)(4)-8(b)(3).

IRS Response: The Service representative agrees with the proposed response that there is no requirement that this kind of design be set up as a money purchase pension plan. The Service representative indicated that it is very much a plan design question – whether it is a profit sharing or money purchase plan. The Service representative pointed out that the plan would not be eligible for the nondiscrimination safe harbor because the nondiscrimination safe harbor is specific to a money purchase pension plan. However, for this particular question the facts indicate that the plan is designed not to be within the safe harbor, but it's designed to have a general test, nondiscrimination approach. Ultimately, the Service representative indicated that the Service agrees that it can be a profit sharing plan, but it would have to satisfy the general test rather than the safe harbor.

7. § 401(a) – Rollover to an IRA

Participant X has a \$10,000 balance in his Section 401(k) plan. \$9,000 of this is pre-tax contributions and earnings thereon, \$900 is after-tax contributions and \$100 is earnings on the after-tax contributions. The Section 401(k) plan permits withdrawals of participant after-tax contributions at any time.

Participant X takes a distribution of \$1,000 consisting of just his after-tax contributions and the earnings thereon and rolls over the after-tax contributions to a Roth IRA and the earnings to a traditional IRA.

Question A: In light of the recent guidance in IRS Notice 2014-54, can the participant make an election to withdraw only his after-tax contributions and roll over the after-contributions to a Roth IRA and the earnings on the after-tax contributions to a traditional IRA?

Question B: If Question A is permitted, how would the pro rata taxation rules under Code Section 72 work?

Proposed Response A: Yes. The participant is not required to take a distribution of his entire account to take advantage of new allocation rules issued under IRS Notice 2014-54, provided the Section 401(k) plan permits withdrawals of participant after-tax contributions. In this case, based on the participant's election, the record keeper would issue two checks, one check (for after-tax contributions) payable to the Roth IRA and the second check (for earnings on after-tax contributions) payable to the traditional IRA.

Proposed Response B: In this case, the pro-rata rule under Code Section 72 doesn't apply since the participant is taking a distribution of only his after-tax contributions which is permitted by the Section 401(k) plan.

IRS Response: The Service representative agrees with Proposed Responses A and B. The Service representative pointed out that one very important fact presented in this question, which is key to the IRS' response, is that there is separate accounting for the after-tax and pre-tax portions of the benefit. The Service representative stated that the rule is that you can take out just the after-tax or just the pre-tax with earnings, and Notice 2014-54 is dedicated to the proposition that the individual can make an election about where the different pieces of the distribution end up.

8. § 401(k) – Alternative Defined Contribution Plan

Company A and Company B are members of a controlled group of corporations under Section 414(b) of the Code. Both companies sponsor Section 401(k) plans ("Plans") for their respective employees.

On December 31, 2011, all 100 of Company B's employees were eligible to participate in Company B's Plan. On January 1, 2012, Company B terminated the employment of 95 employees and the remaining 5 employees were transferred to Company A where they were eligible to participate in Company A's Plan. As of January 1, 2014, Company B had zero employees, but the 100 former employees (including the 5 transferred to Company A) maintain account balances in the Company B Plan.

Company B terminated its Plan effective December 31, 2013 and made distributions to all former 100 employees who still maintained an account balance in the Plan.

Treas. Reg. Section 1.401(k)-1(d)(4) provides, "A distribution may not be made . . . if the employer establishes or maintains an alternative defined contribution plan. For purposes of the preceding sentence, the definition of the term 'employer' contained in Section 1.401(k)-6 is applied as of the date of plan termination, and a plan is an alternative defined contribution plan only if it is a defined contribution plan that exists at any time during the period beginning on the date of plan termination and ending 12 months after distribution of all assets from the terminated plan. However, if at all times during the 24-month period beginning 12 months before the date of plan termination, fewer than 2% of the employees who were eligible under the defined contribution plan that includes the cash or deferred arrangement as of the date of plan termination are eligible under the other defined contribution plan, the other plan is not an alternative defined contribution plan."

Question A: Is Company A's Plan an alternative defined contribution plan?

Question B: If Company A's Plan is an alternative defined contribution plan, does the 2% exception apply?

Proposed Response to Question A: Yes. Company A's Plan is an alternative defined contribution plan because it existed on the date of termination of Company B's Plan (and for the 12 months after distribution of the Plan's assets).

Proposed Response to Question B: Yes. In calculating the 2% threshold, Company B looks back 12 months from the date of termination and 12 months after the date of plan termination to determine how many employees it has and how many of those employees were eligible to participate in Company A's Plan (*i.e.*, the alternative defined contribution plan). During the 24-month period surrounding the Plan termination, Company B had zero employees (all employees were terminated more than 12-month prior

to the termination). As a result, Company B has zero *employees* that are eligible to participate in Company A's Plan, which is fewer than 2%.

IRS Response: The Service representative indicated that the Service could not quite come to a consensus on the answer to this in a timely fashion and recommended that it be submitted again next year. He stated that the Service probably will be able to come to a consensus regarding the question.

9. § 401(k) – Expenses Eligible for Hardship Distributions

An employee requested a hardship for post-secondary education and attached a contract from a cosmetology school for \$5,000. The term "post-secondary education" is not defined in the plan document. Is cosmetology school considered post-secondary education?

Proposed Response: Neither the Internal Revenue Code nor the plan document defines "postsecondary education" in the context of hardship distributions. However, the IRS does provide a comparable definition in the context of educational tax credits. The IRS defines an "eligible educational institution" as any postsecondary educational institution eligible to participate in a student aid program run by the U.S. Department of Education. Generally, this includes most accredited post-secondary institutions. If an institution is eligible to participate in a student aid program run by the Department of Education, it meets the requirements of post-secondary education for purposes of a hardship distribution.

IRS Response: The Service representative agrees with the proposed response. The Service representative indicated that based on the rationale presented in the proposed response, attendance at the post-secondary cosmetology school would count towards the definition of post-secondary education for purposes of qualifying for a hardship distribution.

10. § 401(k) – Treatment of Plan Loans in Connection with Acquisition

Company A and Company B enter into a merger agreement whereby Company A will acquire Company B. Pursuant to the terms of the merger agreement, Company B's 401(k) plan must be terminated prior to the effective date of the merger. Company B terminates its 401(k) plan the day before the closing of the merger. Following the merger, Company A will allow direct rollovers from Company B's plan into Company A's plan. In connection with termination of Company B's plan, Company B intends to seek a favorable determination letter. May a participant who has an outstanding loan under Company B's plan as of the date of plan termination continue to make loan repayments to Company B's plan following the plan termination date until the participant is eligible for a distribution?

Proposed Response: Yes. Loan repayments are not new contributions to the plan because they do not increase a participant's account balance. Permitting loan repayments following the date of termination will not impact the date of plan termination. Loan repayments must be made in accordance with the terms of the loan policy.

IRS Response: The Service representative agrees with the proposed response. The Service representative indicated that permitting loan repayments will not affect the date of the plan termination and that can continue to happen. However, the Service representative noted in Revenue Ruling 89-87, the assets of the plan need to be distributed as soon as administratively feasible after the date of the termination. Furthermore, the Service representative indicated that, for example, if this is a 30 year loan for a house, it does not appear that the suggestion was that the plan does not actually get terminated for 30 years. Presumably, there is a point in time when the loan repayments would end – but for a period of time after the date of the plan termination, that would not be problematic.

11. § 401(k)(13) – Dual Eligibility and Safe Harbor Plan

An employer establishes a Section 401(k) plan. The plan includes eligibility requirements for one group of employees based upon age or service conditions that are lower than those required by Code Section 410(a)(1) while requiring a second group of employees to satisfy the Section 410(a) statutory eligibility requirements. The 401(k) also plan intends to comply with Code Section 401(k)(13). The first group of employees is not eligible for the safe harbor contributions under Section 401(k)(13); the latter group is.

Does the dual eligibility requirement affect the plan's ability to qualify as a safe harbor plan under Section 401(k)(13)?

Proposed Response: No, dual eligibility does not affect the plan's treatment under Section 401(k)(13). Notice 98-32, IX(B)(1) provides:

The rules that apply for purposes of aggregating and disaggregating CODAs and plans under §§ 401(k) and 401(m) also apply for purposes of §§ 401(k)(12) and 401(m)(11), respectively. See §§ 1.401(k)-1(b)(3) and 1.401(m)-1(b)(3). . . Similarly, if, pursuant to §410(b)(4)(B), an employer applies §410(b) separately to the portion of a plan (within the meaning of §414(l)) that benefits only employees who satisfy age and service conditions under the plan that are lower than the greatest minimum age and service conditions permitted under §410(a), the plan is treated as two separate plans for purposes of § 401(k), and the ADP test safe harbor need not be satisfied with respect to both plans in order for one of the plans to take advantage of the ADP test safe harbor.

This was amplified in Notice 2000-3:

Q-10. Is a plan required to provide safe harbor matching or non-elective contributions to participants who have not yet attained age 21 and completed a year of service if the plan uses one of the 401(k) safe harbor methods?

A-10. As provided in section IX.B.1. of Notice 98-52, if, pursuant to §410(b)(4)(B), an employer applies §410(b) separately to the portion of a plan (within the meaning of §414(l)) that benefits only employees who satisfy age and service conditions under the plan that are lower than the greatest minimum age and service conditions permitted under §410(a), the plan is treated as two separate plans for purposes of §401(k), and the ADP test safe harbor need not be satisfied with respect to both plans in order for one of the plans to take advantage of the ADP test safe harbor. Accordingly, a plan that uses one of the 401(k) safe harbor methods is not required to provide safe harbor matching or non-elective contributions to participants who have not yet attained age 21 and completed a year of service. Those employees do not have to be treated as eligible employees for purposes of the 401(k) safe harbors, so long as the employer has elected to treat them separately for coverage purposes pursuant to §410(b)(4).

Since Section 401(k)(13) was added by PPA 2006, the safe harbor guidance issued before then could not address it. However, as Section 401(k)(13) is an alternative method of meeting non-discrimination requirements like §401(k)(12) is, the same holding would also apply to Section 401(k)(13) plans.

Since Treas. Reg. §1.410(b)-7(c)(3) permits disaggregation of plans that base eligibility to employees that do not satisfy the Code §410(a) requirements, Treas. Reg. §1.401(k)-1(b)(4)(iv)(A) provides that the arrangements are treated separately. Treas. Reg. 1.401(m)-1(b)(4)(iv) provides the same outcome for matching contributions.

Finally, Example 2 of Treas. Reg. §1.401-1(b)(4)(vi) describes a plan that applies Code §410(b)(4) [which allows pre-§410(a)(1) employees to participate in a separate plan] to disaggregate its plans, one of which is a safe harbor plan and the other is not. The example approves of the arrangement, provided that the non-safe harbor plan passes ADP testing required for non-safe harbor plans.

IRS Response: The Service representative agrees with the proposed response and agrees that the plan disaggregation rules under Treas. Reg. § 1.401(k)-1(b)(4)(iv)(A) apply to Section 401(k)(12) and Section 401(k)(13) plans.

12. § 409A – Non-Public Company Joining Public Company Controlled Group

Under Treas. Reg. Section 1.409A-1(i)(6), in the event of a corporate transaction in which a non-public company joins the controlled group of a public company, the non-public company's employees are not taken into account until the next "specified employee effective date," generally the next April 1. Assume that a corporate transaction occurs on March 1, 2016, and the public company has a specified employee identification date of December 31, 2015 and a specified employee effective date of April 1, 2016. Are the non-public company's employees taken into account starting April 1, 2016? Or not until April 1, 2017?

Proposed Response: The non-public company's employees are taken into account starting April 1, 2017. The employees were not employees of the public company or its controlled group on December 31, 2015, so they should not be taken into account starting April 1, 2016.

IRS Response: The Service representative agrees with the proposed response. Since the individuals of the acquired company were not employed on the identification date, they are not covered as of April 1, 2016, but instead are covered one year later, on April 1, 2017, assuming they continue to be employed by the controlled group.

13. § 409A – One Time and Form of Payment

Treasury Regulation Section 1.409A-3(c) provides that a plan may designate only one time and form of payment upon the occurrence of events such as separation from service, with a limited exception if the event occurs before a specified date, such as a retirement age. How does this rule apply if participants are allowed to designate for each year's deferral a different post-retirement starting date and form? For example, what if a participant designates that 2014 salary deferrals be paid 5 years after retirement in a lump sum, and that 2016 deferrals start at retirement date in a 10-year installment form? Has the plan violated the requirement that only one time and form of payment may be offered after separation from service?

Proposed Response: Although Treasury Regulation Section 1.409A-3(c) refers to a limit per plan, it was not meant to provide that all deferrals under the plan be so limited, provided that the payment of each yearly deferral, with deemed investment earnings on that amount, can be objectively determined under Treasury Regulation Section 1.409A-3(i)(1)(i).

IRS Response: The Service representative agrees with the proposed response. Deferrals for each year are separate deferred amounts to which the time and form of payment rules apply separately.

14. § 409A – Six Month Delay for Specified Employee

A specified employee is entering into an employment with a publicly traded company. The agreement provides that if the employee is terminated without cause by the company, he is entitled to receive

severance in accordance with the Company's payroll practices for a period of six months. The severance payment amount is less than the separation pay exception amount. The employment agreement also provides that if the employment expires on its own terms and the employee stops performing services for the company, the employee is entitled to receive payment for a six month restrictive covenant period. The payments will be made in accordance with the Company's payroll practices for a period of six months. Since the employee is a specified employee, does the six month delay apply to either the severance payment or the restrictive covenant payment?

Proposed Response: The two payments are separately identifiable amounts under Section 409A. As a result, the six month delay does not apply to the severance payment since the severance payment fits within the separation pay exception. The restrictive covenant payment is subject to the six month delay for specified employees since it is paid on a voluntary separation from service.

IRS Response: The Service representative disagrees with the proposed response. Since the individual will receive six months of pay regardless of whether he voluntarily or involuntarily terminates, the Service will disregard the purported separate nature of the two plans and would consider them all to be payments upon voluntary termination subject to the six month delay period.

15. § 409A – Short Term Deferral and Release

Employee enters into an employment agreement with his employer. The employment agreement provides for severance pay that will be paid within five days following the date on which the employee executes a release agreement. The employment agreement also provides that in no event will severance be paid more than 60 days following employee's termination of employment. The severance payment is intended to fit within the short-term deferral exception to Section 409A. If the release consideration period spans two calendar years, must the payment of severance benefits be delayed until the second calendar year? Must the employment agreement contain language requiring the payment to be paid in the second calendar year?

Proposed Response: No. Since the payments fit within the short-term deferral exception to Section 409A, the payments do not need to be delayed until the second calendar year.

IRS Response: The Service representative agrees with the proposed response, but with the caveat that no opinion is given on the application of the constructive receipt doctrine in situations where executing a release is required in order to receive a payment.

16. 410(b); §401(k) – Applicability of Transition Period Coverage Testing Relief

In the stock acquisition, assume that the Target company maintains a 401(k) plan that is not a safe harbor plan, while Acquirer maintains a safe harbor 401(k) plan. Can Section 410(b)(6)(C) be used following the acquisition to effectively treat the plans as not in same controlled group for the transition period under that section, with or without any plan amendments, such that the plans are tested separately for coverage, and Acquirer's plan continues to be a safe harbor plan exempt from ADP/ACP testing, while Target's plan remains subject to ADP/ACP testing?

Proposed Response: Yes, an employer may maintain two separate 401(k) plans, one a safe harbor and one not a safe harbor, as long as the two plans separately pass coverage testing under Section 410(b), including through use of the rule of Section 410(b)(6)(C).

IRS Response: The Service representative agrees with the proposed response, but added that its response assumes that there are no plan amendments that would significantly change the coverage under the plans during that period.

17. § 415 – Definition of Compensation

If an employer elects “W-2 Compensation” or “Federal Income Tax Withholding Wages” as the definition of compensation in a tax-qualified plan, and self-employed individuals are covered by the plan, is the “earned income” of the self-employed individuals included in compensation for plan purposes, including the Code Section 415 limit?

Proposed Response: Yes.

Self-employed individuals, including sole proprietors of unincorporated businesses and partners who perform services in a partnership, receive self-employment income that is subject to self-employment tax under Code §1401 *et seq.* Code §401(c) provides that a self-employed individual who receives “earned income” is treated as an employee for purposes of “this section” (*i.e.*, Code §401). Code §401(c)(2) defines “earned income” as income from self-employment within the meaning of Code §1402(a) with certain modifications. Self-employment income is reported on Schedule SE to the self-employed individual’s federal income tax return, and is based on information provided on Form K-1 (in the case of a partner in a partnership) or Schedule C (in the case of a sole proprietor). Self-employed individuals do not receive a W-2 Form, and their self-employment earnings are not subject to Federal income tax withholding pursuant to Code § 3401 *et seq.* “Earned income” as defined in Code §401(c)(2) is used to calculate the deduction limit for a qualified plan pursuant to Code §404(a)(8).

Code §401(a)(16) requires a tax qualified plan to limit allocations and benefits in accordance with Code §415. In a defined contribution plan, Code §415(c) generally limits contribution and forfeiture allocations to an individual plan participant to 100% of the participant’s compensation (or an indexed dollar limit, if less). For this purpose, Code §415(c)(3)(B) provides a “Special Rule for Self-Employed Individuals,” which substitutes the definition of “earned income” in Code §401(c)(2) (with certain modifications) for “compensation” for purposes of this limit. In defined benefit plans, Code §415(b)(3) likewise requires that “earned income” within the meaning of Code § 401(c)(2) (with certain modifications) be used in calculating the benefit limitations of §415(b) for self-employed individuals.

Treas. Reg. §1.415(c)-2(a) states that compensation for purposes of §415 means all items of remuneration described in §1.415(c)-2(b), and excludes items described in §1.415(c)-2(c). Among other things, Treas. Reg. §1.415(c)-2(b)(2) states that, in the case of an employee within the meaning of Code §401(c), compensation includes the individual’s “earned income” as defined in Code §401(c) and regulations thereunder.

Treas. Reg. §1.415(c)-2(a) states that a plan may use a safe harbor definition of compensation described in Treas. Reg. §1.415(c)-2(d) “in lieu of” the generally applicable definition found in §1.415(c)-2(b) and (c). Treas. Reg. §1.415(c)-2(d)(3) and (4) offer two popular alternative definitions, including “Section 3401(a) Wages”, commonly referred to as “Federal Income Tax withholding wages,” and “Information Required to be Reported Under Sections 6041, 6051 and 6052,” commonly referred to as “W-2 Wages.” Most preapproved plans offer these two alternative compensation definitions as a box to be checked by the adopting employer.

Adoption of one of the alternative compensation definitions in Treas. Reg. §1.415(c)-2(d)(3) or (4) should not be interpreted to preclude inclusion of “earned income” of a self-employed individual in compensation for calculating the Code §415 limits or for other plan purposes, given that the statutory

provisions repeatedly require “earned income” to be used for plans that cover self-employed individuals. These “safe harbor” definitions should be interpreted to be “in lieu of” the general definition of Code § 415 compensation only insofar as common law employees who are subject to W-2 reporting and wage withholding under Code §3401 are covered, and should not be interpreted to abrogate the statutory definition of “earned income” for self-employed individuals.

IRS Response: The Service representative agrees with the proposed response. The Service representative also agrees with the reasoning in the proposed response.

18. § 415 – Limitation on Accruals

A defined benefit plan provides an accrued benefit derived from credited service and an average of the participant’s five highest annual wages among the last ten years. The plan provides for a fully subsidized (that is, not subject to any actuarial reduction for early commencement) early retirement benefit upon the sum of the participant’s age and service equaling or exceeding 88. This valuable “Rule of 88” early retirement subsidy and the adjustment required under Code Section 415(b)(2)(C) for benefits beginning before age 62 combine to result in some participants’ annual benefits exceeding the limitation applicable under Code Section 415(b)(1)(A) at a relatively young age. Yet as such a participant ages without commencing distribution of his or her accrued benefit, the adjustment under Code Section 415(b)(2)(C) decreases, and the Code Section 415(b)(1)(A) limitation is unlikely to be met or exceeded in future years, despite the participant remaining employed.

As required by Treas. Reg. 1.415(a)-1(d)(1) and 1.415(b)-1(a)(3), the plan precludes the possibility that any annual benefit exceeding the Code Section 415 limitations will be accrued. When that preclusion is applied to a participant whose annual benefit has reached the applicable Code Section 415 limitation and who remains employed, must the plan permanently exclude any benefit accrual service and/or wages that otherwise would have been credited after accruals became limited under Treas. Reg. 1.415(a)-1(d)(1) and 1.415(b)-1(a)(3)?

Proposed Response: No. Treasury regulations limit the annual benefit that may be accrued. A plan must include provisions limiting the annual benefit that may be accrued and would be payable. Neither Code Section 415 nor the corresponding Treasury regulations, however, require that benefit accrual service and/or wages be permanently excluded following a participant’s reaching the applicable Code Section 415 limitation. Accordingly, if a participant’s benefit accruals become limited, but a higher Code Section 415 limit later applies, benefit accrual service and wages that otherwise would have been credited (if not for Code Section 415 limitations on benefits accrued) may be taken into account when calculating the participant’s accrued benefit when such higher limit applies (providing that the plan continues to limit the accrued benefit and benefit payable to the applicable Code Section 415 limit).

IRS Response: Although the Treasury regulations limit the benefit that a participant can accrue, there is no permanent exclusion here. As the benefit accruals and wages continue to be credited, a participant’s accrued benefit can increase.

19. § 457(b) – Deferral of Sick Leave

Employees of Organization A, a local government, receive a certain number of sick days per year that allow them to take time off and still get paid at the normal hourly rate. If an employee does not take all sick days allowed during the year, those sick days may be accrued and taken at a later time. If an employee retires, the Organization will pay such employee in a lump sum in the month following retirement \$100 per accrued sick day up to a maximum amount of \$10,000. If the employee severs employment prior to being eligible to retire, the sick leave balance is forfeited. The amount paid per

accrued sick day is the same for all employees, independent and irrespective of an employee's actual hourly wage. As a result, the sick leave cashed out to an employee upon retirement is most often different than the amount the employee would have received had he/she taken the sick days while still employed.

Can an employee defer sick leave cash out under the Organization's 457(b) Deferred Compensation Plan ("the Plan") where the amount actually cashed out to the employee is different (more or less) than the dollar amount of sick leave the employee would have received if employment had continued and the leave had been used during employment?

Proposed Response: No. If the sick leave cash-out is an amount different than that which the employee would have received had employment continued, the sick leave that is paid after severance is not includible compensation and cannot be deferred under 457(b).

Analysis

Treas. Reg. § 1.457-4(d) states that an eligible plan may provide that deferrals may be made for former employees with respect to compensation described in § 1.415(c)-2(e)(3)(i).

Under Treas. Reg. § 1.415(c)-2(e)(3)(i), the plan may provide that amounts described in paragraph (e)(3)(iii) are included in compensation (within the meaning of section 415(c)(3)) if:

(A) Those amounts are paid by the later of 2½ months after severance from employment with the employer maintaining the plan or the end of the calendar year that includes the date of severance from employment with the employer maintaining the plan; and

(B) Those amounts would have been included in the definition of compensation if they were paid prior to the employee's severance from employment with the employer maintaining the plan.

An amount is described in (e)(3)(iii) if the amount is payment for unused accrued bona fide sick, vacation, or other leave, *but only if the employee would have been able to use the leave if employment had continued.*

Likewise, under the Plan, the definition of Compensation includes leave cash-outs for unused accrued bona fide sick leave, *but only if the Participant would have been able to use the leave if Employment had continued.*

Since the amount of sick leave actually cashed-out to the employee is different than the unpaid sick leave the employee had actually accrued, the employee would not have been able to use the leave had employment continued. Therefore, the sick leave that is cashed-out after severance is not includible compensation and cannot be deferred.

For example, if Employee had accrued \$80 of unpaid sick leave, but was actually cashed-out \$100 of sick leave, Employee could not defer the sick leave cashed out to him because he would not have been able to use the entire \$100 of leave cash-out had employment continued.

In the alternative, we can see that it is possible to argue that the Employee ought to be able to defer to the 457(b) Plan in this situation the lesser of: (a) the value of the sick leave at the employee's rate of pay; or (b) the cash out amount; or (c) the applicable 457(b) annual deferral limit.

IRS Response: The Service representative agrees with the proposed response. The Service representative stated that the citation in support of the response is Treas. Reg. § 1.415(c)-2(e)(3)(iii), which provides that if the amount is payment for unused accrued bona fide sick leave, vacation, or other

leave that is taken into account, but only if the employee would have been able to use the leave if employment had continued.

20. § 501(c)(9) – Determination of Value of Benefits

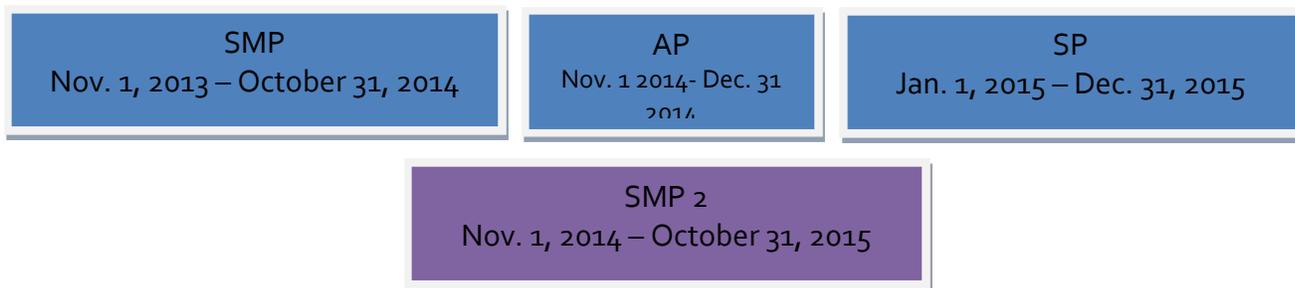
For the purpose of determining whether a Section 501(c)(9) VEBA that provides one or more fully-insured, wholly employee-paid “voluntary” benefits systematically and knowingly provides impermissible benefits of more than a *de minimis* amount, must the VEBA include the amount paid by employees toward the cost of such “voluntary” benefits in determining (a) the value of a “voluntary” impermissible benefit, or (b) the value of all benefits, including “voluntary” permissible benefits, provided by the VEBA?

Proposed Response: In circumstances where it is reasonable for a VEBA to determine the value of a benefit provided by the VEBA on the basis of the cost paid to provide such benefits, the VEBA must include amounts paid by members toward the cost of such benefits in determining both the value of impermissible benefits provided by the VEBA, and the value of all benefits provided by the VEBA. Regardless of any determination made on this basis, an organization is not a VEBA unless substantially all of its operations are in furtherance of the provision of life, sick, accident, or other benefits.

IRS Response: In circumstances where it is reasonable for a VEBA to determine the value of a benefit provided by the VEBA on the basis of the cost paid to provide such benefits, the VEBA must include amounts paid by members toward the cost of such benefits in determining both the value of impermissible benefits provided by the VEBA and the value of all benefits provided by the VEBA. Regardless of any determination made on this basis, an organization is not a VEBA unless substantially all of its operations are in furtherance of the provision of life, sick, accident, or other benefits as described in Treas. Reg. § 1.501(c)(9)-3. The Service representative noted that this is basically the proposed response with an added clause at the end.

21. § 4980H – Determining Full-Time Status

As illustrated below, employer has a calendar year plan. The employer is not an educational organization. For ongoing employees, the employer uses a 12 month look back period, followed by an AP of less than 90 days and a 12-month stability period that aligns with the employer’s plan year. An employee is identified in the look-back measurement period as an FTE and is offered affordable, MV coverage on the first day of the plan year.



Employee A is an ongoing employee. Employee A was identified as a full-time employee in the SMP and is offered affordable, MV coverage effective January 1, 2015. She accepts the coverage. On April 1, 2015 the Employee A goes out on an unpaid, non-FMLA (non-USERRA and non-jury duty leave). Employee A remains the employee of the employer (she is not terminated). Employee A comes back September 1, 2015.

Question 1: When the employee returns September 1, is she treated as a new employee because the period with no hours of service is at least 13 weeks?

Proposed Response 1 (A or B):

A. Yes. Even though Employee A earned full-time status in the SMP for the entire SP 2015, because she had no hours of service for a period of at least 13 consecutive weeks the employer may treat Employee A as a new hire beginning September 1, 2015. If, when Employee A returns she is a new hire variable hour, seasonal or part-time employee an initial measurement period (IMP) may be used to determine full-time status. If she is a new hire full-time employee, the offer of coverage must be made within 90 days. She is not a continuing employees and the fact that she has earned full-time status for the entire SP based on her hours worked in the prior SMP is irrelevant because she had a break in service of at least 13 consecutive weeks.

Or

B. No, as she remained an employee of the employer during her leave, she retains her status as a FTE for the entire SP. However, her hours are re-evaluated in SMP 2 to determine FTE status for SP 2016.

Question 2: If A is the correct answer. What is her status while on unpaid leave (but still an employee) for the months of April – August. Is she the full-time employee of the employer during this time?

Proposed Response 2 (A or B):

A. Yes. Even though she has no hours of service from April – August, Employee A is still the full-time employee of the employer during that time.

Or

B. Yes, but at week 13 Employee A no longer is considered the full-time employee of the employer.

IRS Response: The Service representative agrees with Proposed Response A for Question 1. Even though Employee A earned full time status in the standard measurement period for the entire 2015 stability period, because the employee had no hours of service for a period of at least 13 consecutive weeks, the employer may treat the employee as a new hire beginning September 1, 2015. If, when the employee returns, they are a new hire or variable hours, seasonal or part time employee, an initial measurement period may be used to determine full time status. That means the employer would not be offering them coverage right away. If a new hire is full time employed, the offer of coverage must be made within 90 days. As of September 1, 2015, the employee is not a continuing employee and the fact that the employee earned full time status for the entire stability period based on the hours worked in the prior standard measurement period is irrelevant because they had a break in service of at least 13 consecutive weeks.

The IRS agrees with Proposed Answer A for Question 2. The employer did not terminate the employee so you look at the look back method which indicates that they are a full time employee. So as long as Employee A remains an employee of the employer, the employee is a full time employed for purpose of 4980H because the employee is still in the stability period in which the employee is treated as a full time employee. If, however, Employee A's employment was terminated at any time during the unpaid leave, the employee would no longer be either an employee or a full time employee for the remainder of the stability period unless rehired within 13 weeks in which case the employee would be treated as a continuing employee.

22. § 4980H – Monthly Measurement Method

The final regulations provide that for a new employee who is reasonably expected at the employee's start date to be a full-time employee (and is not a seasonal employee), an applicable large employer determines the employee's full-time status based on the employee's hours of service for each calendar month. The regulations further provide that "an employer is not subject to an assessable payment under section 4980H(a) with respect to an employee for each calendar month during the period of three full calendar months beginning with the first full calendar month in which the employee is otherwise eligible for an offer of coverage under a group health plan of the employer, provided that the employee is offered coverage no later than the first day of the first calendar month immediately following the three-month period if the employee is still employed on that day."

If a new employee is reasonably expected at the employee's start date to be full-time and is in fact full-time for the first full calendar, but turns out not to be full-time after the first full calendar month, must the employer still offer coverage by the first day of the first calendar month immediately following the three-month period? Can the employer then change the employee's category to use the look-back measurement method? For example, if the employee was hired as a salaried employee, can the employer change the employee to hourly if the look-back measurement is used for hourly employees?

Proposed Response: If a new employee who is reasonably expected at the employee's start date to be full-time subsequently becomes a part-time employee within the employee's first three months of employment, the employer may change the employee from a category under which the monthly measurement method is used to a category under which the look-back measurement method is used to determine the employee's status as a full-time employee. Accordingly, the employer would not be required to offer coverage by the first day of the first calendar month immediately following the conclusion of the employee's initial three full calendar months of employment.

The employer would determine whether the new employee is full-time using an initial measurement period that begins on a date that dates back to the employee's start date or on any date up to and including the first day of the first calendar month following the employee's start date (or on the first day of the first payroll period starting on or after the employee's start date, if later). If the employee has on average at least 30 hours of service per week during the initial measurement period, the applicable large employer must treat the employee as a full-time employee during the stability period that begins after the initial measurement period (and any associated administrative period).

The employer would not be subject to an assessable payment under Section 4980H(a) with respect to the employee for each calendar month during the employee's initial three full calendar months of employment. The employer would also not be subject to an assessable payment under Section 4980H(a) for any calendar month during the initial measurement period and any associated administrative period, provided that the employee is offered coverage by the employer no later than the first day of the associated stability period if the employee is still employed on that day.

IRS Response: The Service representative stated that a new employee's status as variable hour or non-variable hour employee is determined based on the employer's reasonable expectations as of the employee's time of hire. If an employee is reasonably expected to average at least 30 hours of service per week at the time of hire, then the employee status as a full-time employee or non-full-time employee is determined based on the employee's actual hours of service for each calendar month. The regulations do not provide for a subsequent recategorization of a new full-time employee as a new variable hour employee so the employee will remain a new full-time employee until completion of the full standard measurement period.

23. § 4980H – Monthly Measurement Period/COBRA Application

Treasury Regulation Section 54.4980H-3(d)(2)(i) provides: “For a new employee who is reasonably expected at the employee’s start date to be a full-time employee (and is not a seasonal employee), an applicable large employer member determines such employee’s status as a full-time employee based on the employee’s hours of service for each calendar month. . . . Once a new employee who is reasonably expected at the employee’s start date to be a full-time employee (and is not a seasonal employee) becomes an ongoing employee, the rules set forth in paragraph (d)(1) [*i.e.*, the standard measurement and stability period rules] of this section apply for determining full-time employee status.”

IRS Notice 2014-49 provides that if an employee (i) is not in a stability period or measurement period; and (ii) experiences a change in employment status (a “Status-Change Employee”), then “the employee’s status as a full-time or non-full-time employee is determined solely under the look-back measurement method applicable to the second position as of the date of transfer, including all hours of service in the first position.” However, until a Status Change Employee “has been employed for a full standard measurement period applicable to the second position (including service in the first position), the status of the employee as a full-time employee or non-full-time employee for § 4980H purposes continues to be determined on the basis of hours of service in each month.”

Employer B utilizes a standard measurement period that begins on January 1 and ends on December 31 for purposes of determining its full-time employees. The corresponding standard stability period begins on the immediately following January 1 and ends on the following December 31. Employee A was hired as a full-time employee (*i.e.*, 30 or more hours per week) on April 12, 2014. Employee A elected to enroll in Employer B’s group health plan effective as of July 1, 2014. Employee A transferred to a part-time position on February 28, 2015 and became ineligible for coverage. Employee A’s group health plan coverage terminates on February 28, 2015 in accordance with the terms of the plan.

What measurement period applies to Employee A when he becomes a part-time employee? How does COBRA interact with subsequent offers of coverage that may have to be made during 2015?

Proposed Response: Employee A was initially hired as a full-time employee, and must be offered coverage not later than the first day of the fourth month following his April 12 hire date under the limited nonassessment rules. Employee A, when he switches to part-time status, must still be measured (for group health plan eligibility purposes) under the monthly measurement period because he had not been employed for a full standard measurement period when his employment status changed. Employer B must offer COBRA coverage to Employee A based upon his reduction in hours and loss of group health plan coverage on February 28, 2015. If Employee A averages 30 hours of service per week during March 2015, Employer B must offer to reinstate Employee A’s group health plan coverage immediately retroactively back to March 1, 2015. Any COBRA coverage that Employee A elected would terminate when Employee A reenrolled in Employer B’s group health plan. Employer B would continue to measure Employee A’s hours on a monthly basis to determine whether, for that month, Employee A is eligible to enroll in group health plan coverage. Each time that Employee A was (i) enrolled in the group health plan coverage; and (ii) subsequently lost coverage because he did not work 30 hours per week for a particular month, Employer B must make a new offer of COBRA coverage that is subject to a new 18-month maximum coverage period.

IRS Response: Employee A was initially hired as a full-time employee and his status as full-time or non-full-time employee is thus determined on the basis of hours of service in each month until completion of a full standard measurement period. When Employee A switches to part-time status, his status as a full-time employee for Section 4980H purposes must still be determined on the basis of hours of service in each calendar month because the employee has not been employed for a full standard measurement period

when his employment status changed. Based on the stated facts, Employee A was ineligible for group health plan coverage under the terms of the plan beginning February 28, 2015. Accordingly, Employer B may owe an assessable payment under Section 4980H(b) for any calendar month in which Employee A averages at least 30 hours a week, assuming that Employee A has purchased coverage on an exchange and receives a premium tax credit for that month. The offer of COBRA continuation coverage does count as an offer of coverage for Section 4980H purposes; however, this offer of coverage would be sufficient to avoid Section 4980H(b) assessable payment only if the offer was affordable and provided minimum value. If Employer B wishes to avoid an assessable payment under Section 4980H(b), one option would be to offer subsidized COBRA coverage at a low enough cost to satisfy one of the affordability safe harbors. The proposed answer as initially drafted seems to assume that Section 4980H could override the plan terms and require coverage in any month in which the employee is full time for Section 4980H purposes. This is not the case. If the terms of the plan state that an employee is ineligible for coverage then Section 4980H is relevant only for purposes of whether an assessable payment is owed not for purposes of plan eligibility.

24. § 6056 – Line 16 of Form 1095-C

Page 6 of the Instructions to Form 1095-C, Part II Employee Offer and Coverage state that: “A code must be entered for each calendar month January through December, even if the employee was not a full-time employee for one or more of the calendar months...”

Page 7 of the Instructions to Form 1095-C, Part II Employee Offer and Coverage state that: “For each calendar month, enter the applicable code, if any, from Code Series 2.”

Does this mean that there are certain circumstances where monthly boxes would be left blank? If yes, what circumstances would warrant a blank box.

Proposed Response: Yes, Line 14 of the Form 1095-C would be left blank or no series 2 code would be entered into the monthly box when none of the series 2 code are applicable to the participant’s or dependent’s circumstances.

IRS Response: Yes, Line 14 should have an entry for each month or the “All 12 Months” box if the same code applies for all 12 months, even if that entry is to indicate that no coverage was offered, which would be code 1H. Line 16, however, could be blank if none of the Series 2 codes apply under the circumstances. Generally, this would be the case for months when no affordable offer of coverage was made to a full-time employee and no other exclusions in the Section 4980H(b) penalty apply with respect to that employee.