Internal Revenue bulletin

Bulletin No. 2013-19
May 6, 2013

HIGHLIGHTS OF THIS ISSUE

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

INCOME TAX

T.D. 9615, page 1026.

These final and temporary regulations eliminate one of the exceptions to the coordination rule governing the overlap of the asset transfer and indirect stock transfer rules, and provide certain technical changes to the rules governing the transfers of stock or securities in a section 361 exchange.

REG–132702–10, page 1042.

This notice of proposed rulemaking cross-references temporary regulations that eliminate one of the exceptions to the coordination rule governing the overlap of the asset transfer and indirect stock transfer rules, and provide certain technical changes to the rules governing the transfers of stock or securities in a section 361 exchange.

EMPLOYEE PLANS

REG–122706–12, page 1043.

This document proposes amendments to regulations, consistent with the Affordable Care Act, concerning the 90-day waiting period limitation for group health coverage as well as amendments to existing requirements such as preexisting condition limitations and other portability provisions added by HIPAA and implementing regulations.

Notice 2013–28, page 1039.

This notice contains updates for the corporate bond weighted average interest rate for plan years beginning in April 2013; the 24-month average segment rates; the funding transitional segment rates applicable for April 2013; and the minimum present value transitional rates for March 2013. The rates in this notice reflect certain changes implemented by the Moving Ahead for Progress in the 21st Century Act, Pub. L. 112–141 (MAP–21).

Finding Lists begin on page ii.

Department of the Treasury
Internal Revenue Service

The IRS Mission

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

Introduction

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

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

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

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

The Bulletin is divided into four parts as follows:

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

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

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

Part IV.—Items of General Interest.
This part includes notices of proposed rulemakings, disbarment and suspension lists, and announcements.

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

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

Section 367.—Foreign Corporations

26 CFR 1.367(a)–1: Transfers to foreign corporations subject to section 367(a): In general

T.D. 9615

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

Indirect Stock Transfers and the Coordination Rule Exceptions; Transfers of Stock or Securities in Outbound Asset Reorganizations

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains final and temporary regulations. These regulations eliminate one of two exceptions to the coordination rule between asset transfers and indirect stock transfers for certain outbound asset reorganizations. The regulations also modify the third exception to the coordination rule for certain outbound exchanges so that this exception is consistent with the remaining asset reorganization exception. In addition, the regulations modify, in various contexts, procedures for obtaining reasonable cause relief. Finally, the regulations implement certain changes with respect to transfers of stock or securities by a domestic corporation to a foreign corporation in a section 361 exchange. The regulations primarily affect domestic corporations that transfer property to foreign corporations in certain outbound nonrecognition exchanges. The text of these temporary regulations serves as the text of the proposed regulations (REG–132702–10) published in this issue of the Bulletin.

DATES: *Effective Date:* The final and temporary regulations are effective on March 19, 2013.

Applicability Date: For dates of applicability, see §1.367(a)–3T(g), §1.367(a)–6T(e)(4), 1.367(a)–7T(e)(2)(iv), 1.1248(f)–3T(a)(3), and 1.6038B–1T(f)(3)(iii).

FOR FURTHER INFORMATION CONTACT: Robert B. Williams, Jr., (202) 622–3860 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information contained in the regulations have 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 1545–2183.

The collections of information are in §§1.367(a)–3(d)(2), 1.367(a)–3T(e)(3) and (e)(6), 1.367(a)–7T(e), 1.1248(f)–3T, and 1.6038–1T(f). The collections of information are mandatory. The likely respondents are domestic corporations.

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

Books and records relating to a collection of information must be retained as long as their contents might become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

On August 20, 2008, the Department of the Treasury (Treasury Department) and the Internal Revenue Service (IRS) issued proposed regulations under sections 367, 1248, and 6038B of the Internal Revenue Code (Code) (2008 proposed regulations) concerning transfers of property by a domestic corporation to a foreign corporation in an exchange described in section 361(a) or (b) (section 361 exchange), and certain nonrecognition distributions of stock of a foreign corporation by a domestic corporation (REG–209006–89, 73 FR 49278; 2008–41 I.R.B. 867). A correction to the 2008 proposed regulations was published in the **Federal Register** on September 26, 2008; 73 FR 56535 (2008–41 I.R.B. 867). No public hearing on the 2008 proposed regulations was requested or held; however, comments were received. All comments are available at *www.regulations.gov* or upon request. Based, in part, on comments received, the Treasury Department and the IRS adopt portions of the 2008 proposed regulations, with modifications, as final regulations elsewhere in this issue of the Bulletin. A portion of the 2008 proposed regulations is adopted, with modifications, in this Treasury decision as temporary regulations.

On February 11, 2009, the Treasury Department and the IRS issued final regulations under section 367 (2009 final regulations) concerning gain recognition agreements with respect to certain transfers of stock or securities by United States persons to foreign corporations (T.D. 9446, 74 FR 6952; 2009–9 I.R.B. 607). A correction to the 2009 final regulations was published in the **Federal Register** on March 27, 2009 (74 FR 13340; 2009–13 I.R.B. 731). The 2009 final regulations included regulations addressing the transfer of stock or securities by a domestic corporation to a foreign corporation in a section 361 exchange. The portion of the 2009 final regulations concerning outbound transfers of stock or securities in a section 361 exchange is withdrawn, revised, and issued in this Treasury decision as temporary regulations.

Explanation of Provisions

A. *Coordination Rule and Exceptions — In General*

Section 1.367(a)–3(d)(2)(vi)(A) (coordination rule) provides that if in connection with an indirect stock transfer, as defined in §1.367(a)–3(d)(1), a U.S. person transfers assets to a foreign corporation (direct asset transfer) in an exchange described in section 351 or section 361, the rules of section 367 and the regulations under that section apply first to the direct asset transfer and then to the indirect stock transfer. There are three exceptions to the coordination rule, as described in this preamble.

Two exceptions to the coordination rule provide that section 367(a) and (d) do not apply to any assets transferred by a domestic acquired corporation to a foreign acquiring corporation in an asset reorganization that are re-transferred to a domestic corporation that is controlled by the foreign acquiring corporation (domestic controlled corporation). These exceptions only apply, however, if the domestic controlled corporation's basis in the re-transferred assets is not greater than the domestic acquired corporation's basis in such assets (the basis comparison rule), and the conditions described in §1.367(a)–3(d)(2)(vi)(B)(*1*)(*i*) (section 367(a)(5) exception) or (d)(2)(vi)(B)(*1*)(*ii*) (indirect domestic stock transfer exception) are satisfied. See §1.367(a)–3(d)(2)(vi)(B)(*1*). The section 367(a)(5) exception applies only if the reorganization satisfies the conditions described in section 367(a)(5) and any regulations issued pursuant to section 367(a)(5). For example, the domestic acquired corporation must be controlled (within the meaning of section 368(c)) by 5 or fewer domestic corporations, and basis adjustments must be made to the stock of the foreign acquiring corporation received in the reorganization. See §1.367(a)–7(c).

The indirect domestic stock transfer exception applies only if the requirements of §1.367(a)–3(c)(1)(i), (c)(1)(ii), and (c)(1)(iv) are satisfied with respect to the indirect stock transfer of stock in the domestic acquired corporation, and certain filing requirements are satisfied.

The third exception (section 351 exception) to the coordination rule applies if a U.S. person (U.S. transferor) transfers assets to a foreign corporation in a section 351 exchange, to the extent that such assets are transferred by such foreign corporation to a domestic corporation in another section 351 exchange. See §1.367(a)–3(d)(2)(vi)(B)(*2*). Consistent with the section 367(a)(5) exception and the indirect domestic stock transfer exception, the section 351 exception only applies if the domestic transferee's basis in the assets is not greater than the basis that the U.S. transferor had in such assets.

B. *Notice 2008–10 and 2008 Proposed Regulations*

On December 28, 2007, the Treasury Department and the IRS issued Notice 2008–10 (2008–1 C.B. 277) in response to outbound asset reorganization transactions that relied on the section 367(a)(5) exception to repatriate earnings of a foreign corporation without the recognition of a corresponding amount of gain or income inclusion. Notice 2008–10 announced that the section 367(a) exception would be revised to clarify that any adjustment to basis required under section 367(a)(5) can only be made to stock of the foreign acquiring corporation received by the controlling domestic corporate shareholders in the asset reorganization. In addition, the notice states that the revised regulations would confirm that to the extent the appropriate amount of built-in gain in the property transferred by the domestic acquired corporation cannot be preserved in the stock received by the controlling domestic corporate shareholders in the reorganization, the domestic acquired corporation's transfer of property to the foreign acquiring corporation is subject to section 367(a) and (d) (see §601.601(d)(2)(ii)(*b*)).

The 2008 proposed regulations would amend the current regulations to incorporate, with modifications, the clarifications to the section 367(a)(5) exception announced in Notice 2008–10. In addition, the preamble to the 2008 proposed regulations states that the Treasury Department and the IRS continue to study transactions that have the effect of repatriating earnings and profits of a foreign corporation without the recognition of gain or a dividend inclusion.

The 2008 proposed regulations also would modify the section 367(a)(5) exception and the indirect domestic stock transfer exception to provide that for purposes of determining whether the domestic controlled corporation's basis in the re-transferred assets is not greater than the domestic acquired corporation's basis in such assets, any increase in basis that results from gain recognized by the domestic acquired corporation on the transfer of the re-transferred assets to the foreign acquiring corporation is not taken into account.

C. *Elimination of Section 367(a)(5) Exception*

The Treasury Department and the IRS have become aware of additional transactions involving outbound asset reorganizations that involve the repatriation of earnings and profits of a foreign corporation where taxpayers take the position that the transaction does not require the recognition of gain or a dividend inclusion. These transactions, which rely on the section 367(a)(5) exception and are structured to avoid gain recognition under section 367(a), may not be affected by the clarifications made to the section 367(a)(5) exception in Notice 2008–10. In one such transaction, for example, the foreign acquiring corporation issues stock and property other than qualified property (within the meaning of section 361(c)(2)(B)) in the reorganization and transfers property that is not eligible for an exception to section 367(a)(1) (such as property used in the United States) to a domestic controlled corporation. The amount of stock issued by the foreign acquiring corporation is sufficient to preserve the built-in gain in the property transferred to it by the domestic acquired corporation in the section 361 exchange. Thus, the parties take the position that the section 367(a)(5) exception applies and that no gain is recognized on the transfer under section 367(a).

Although these types of transactions are not directly covered by Notice 2008–10, they give rise to the same repatriation concerns that the notice was intended to address.

The Treasury Department and the IRS have, over time, clarified and modified the coordination rule exceptions to address various transactions that give rise to policy concerns. See, for example, T.D. 9243 (2006–1 C.B. 475) and Notice 2008–10. These transactions typically do not involve transactions with unrelated parties, but instead arise in connection with transactions with affiliates that appear to be primarily motivated to achieve U.S. tax benefits. After studying these issues further, including in light of the transactions discussed above, the Treasury Department and the IRS no longer believe the section 367(a)(5) exception is appropriate. As a result, the section 367(a)(5) exception is eliminated by the temporary regulations. The indirect domestic stock transfer exception, however, which involves transactions between unrelated parties, is retained.

The Treasury Department and the IRS continue to study nonrecognition transactions that are intended to repatriate earnings and profits of foreign corporations without the recognition of gain or a dividend inclusion.

D. *Domestic Transferee's Basis in Assets for Purposes of the Section 351 Exception*

In response to a comment, the temporary regulations modify the basis comparison rule in the section 351 exception so that it is consistent with the basis comparison rule in the indirect domestic stock transfer exception, as modified by the 2008 proposed regulations. Thus, the section 351 exception is modified in the temporary regulations to provide that for purposes of determining whether the domestic transferee's basis in the assets is not greater than the U.S. transferor's basis in the assets, any increase in basis that results from gain recognized by the U.S. transferor with respect to such assets in the initial section 351 exchange is not taken into account.

E. *Transfers of Stock or Securities in an Outbound Section 361 Exchange*

The current final regulations under §1.367(a)–3(e) provide the general rule that the outbound transfer of stock or securities in a section 361 exchange is subject to section 367(a)(1), unless specified conditions are satisfied. One condition is that the requirements of section 367(a)(5) and any regulations thereunder must be satisfied. Another condition is that any control group member that owns (with attribution) five percent or more of the stock (by vote or value) of the transferee foreign corporation immediately after the transaction must enter into a gain recognition agreement with respect to the control group member's share of the gain (based on its ownership interest in the U.S. transferor) (GRA requirement).

In connection with final regulations under section 367(a)(5), published in T.D. 9614, 2013–17 I.R.B. 947, these temporary regulations make conforming modifications to the GRA requirement such that the five-percent ownership threshold is determined by reference to the U.S. transferor's ownership of the transferee foreign corporation (rather than by reference to ownership of the transferee foreign corporation by control group members). For this purpose, ownership is determined immediately after the U.S. transferor's transfer of the stock or securities to the transferee foreign corporation in the section 361 exchange, but prior to and without taking into account the U.S. transferor's distribution under section 361(c) of the stock received. If the U.S. transferor meets the five-percent ownership threshold with respect to the transferee foreign corporation, then two conditions must be satisfied in order to be eligible to file a GRA. The first condition is that each shareholder of the U.S. transferor that is a "qualified U.S. person" (generally, any U.S. person except domestic partnerships or special corporate entities that are not subject to tax) and satisfies the five-percent ownership threshold must enter into a gain recognition agreement, unless the amount of gain that would otherwise be subject to the gain recognition agreement is zero. The gain recognition agreement is subject to rules in addition to those required under §1.367(a)–8, including special rules for determining the amount of gain subject to the gain recognition agreement. The second condition is that the U.S. transferor must recognize gain realized on the transferred stock or securities attributable to shareholders that are not qualified U.S. persons or do not satisfy the five-percent ownership threshold.

The Treasury Department and the IRS believe that applying the five-percent ownership threshold at the U.S. transferor-level is more consistent with the policy underlying gain recognition agreements. In addition, this change is consistent with the application of §1.367(b)–4(b)(1) to outbound transfers of foreign stock in a section 361 exchange. See §1.367(b)–4(b)(1)(iii), *Example 4*.

Other changes to the current final regulations under §1.367(a)–3(e) conform the rules under §1.367(a)–3T(e) with other provisions, such as the final regulations under §§1.367(a)–7, 1.367(b)–4, 1.1248(f)–1, and 1.1248(f)–2. For example, the regulations provide that §1.367(a)–3T(e) is applied prior to taking into account gain or deemed dividends under any other provisions of section 367, such as under §§1.367(a)–6T, 1.367(a)–7, or 1.367(b)–4.

The other requirements necessary for nonrecognition under the current final regulations of §1.367(a)–3(e) are generally retained, with certain modifications. For example, if the transferred stock or securities are of a domestic corporation, the reporting requirements under §1.367(a)–3(c)(6) must be satisfied, in addition to the requirements under §1.367(a)–3(c)(1)(i), (c)(1)(ii), and (c)(1)(iv).

F. *Coordination of Gain Recognition Rules*

In connection with final regulations under section 367(a)(5), published in T.D. 9614, 2013–17 I.R.B. 947, these temporary regulations make a conforming modification to the current temporary regulations under §1.367(a)–6T by adding a sentence providing that the amount of gain recognized under the branch loss recapture rules is determined prior to determining the amount of any gain recognized under §1.367(a)–7. Accordingly, any gain recognized under the branch loss recapture rules is taken into account in determining the amount of any gain recognized under §1.367(a)–7.

G. *Reasonable Cause Relief Procedures*

The 2008 proposed regulations contain reasonable cause relief provisions in §1.367(a)–7(e)(2), §1.1248(f)–3, and §1.6038B–1(f)(3) (reasonable cause procedures), pursuant to which a taxpayer's failure to timely comply with certain requirements will be deemed not to have occurred if the failure was due to reasonable cause and not willful neglect. These reasonable cause procedures include a provision that a taxpayer will be deemed to have established that the failure to comply was due to reasonable cause and not willful neglect if the taxpayer requesting relief is not notified by the IRS within 120 days of IRS acknowledgement of receipt of the request. The Treasury Department and the IRS do not believe that the IRS's processing time with respect to a relief request should be a determining factor in whether a taxpayer has satisfied its filing obligations. Accordingly, these temporary regulations eliminate the 120-day provision from the reasonable cause procedures. Other than the elimination of the 120-day provision, the reasonable cause procedures are retained in the temporary regulations.

Effective/Applicability Dates

The regulations apply to transactions occurring on or after March 18, 2013.

Effect on Other Documents

The following publication is obsolete as of March 18, 2013:

Notice 2008–10 (2008–1 CB 277).

Special Analyses

It has been determined that these temporary regulations are not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It is hereby certified that the collections of information contained in these regulations will not have a significant economic impact on a substantial number of small entities. Accordingly, a regulatory flexibility analysis is not required. These regulations primarily will affect United States persons that are large corporations engaged in corporate transactions among their controlled corporations. Thus, the number of affected small entities—in whichever of the three categories defined in the Regulatory Flexibility Act (small businesses, small organizations, and small governmental jurisdictions)—will not be substantial. The IRS and the Treasury Department estimate that small organizations and small governmental jurisdictions are likely to be affected only insofar as they transfer the stock of a controlled corporation to a related corporation. While a certain number of small entities may engage in such transactions, the IRS and the Treasury Department do not anticipate the number to be substantial. Pursuant to section 7805(f) of the Code, this regulation has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Robert B. Williams, Jr., of the Office of Associate Chief Counsel (International). However, other personnel from the Treasury Department and the IRS participated in their development.

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Adoption of Amendments to the Regulations

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

PART 1—INCOME TAXES

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

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

Section 1.367(a)–3T is also issued under 26 U.S.C. 367(a).

Par. 2. Section 1.367(a)–3 is amended by:

1. Revising paragraph (d)(2)(vi)(B).
2. Revising paragraph (d)(3) *Examples 6B, 6C, and 9.*
3. Revising paragraph (e).
4. Revising paragraph (g)(1)(vii)(A).
5. Adding paragraph (g)(1)(ix).
6. Adding paragraph (k).

The revisions and additions read as follows:

§1.367(a)–3 Treatment of transfers of stock or securities to foreign corporations.

* * * * *

(d) * * *

(2) * * *

(vi) * * *

(B) [Reserved]. For further guidance, see §1.367(a)–3T(d)(2)(vi)(B).

* * * * *

(3) * * *

Example 6B. [Reserved]. For further guidance, see §1.367(a)–3T(d)(3), *Example 6B*.

Example 6C. [Reserved]. For further guidance, see §1.367(a)–3T(d)(3), *Example 6C*.

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Example 9. [Reserved]. For further guidance, see §1.367(a)–3T(d)(3), *Example 9*.

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(e) [Reserved]. For further guidance, see §1.367–3T(e).

* * * * *

(g) * * *

(1) * * *

(vii)(A) [Reserved]. For further guidance, see §1.367–3T(g)(1)(vii)(A).

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(ix) [Reserved]. For further guidance, see §1.367–3T(g)(1)(ix).

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(k) [Reserved]. For further guidance, see §1.367–3T(k).

Par. 3. Section 1.367(a)–3T is added to read as follows:

§1.367(a)–3T Treatment of transfers of stock or securities to foreign corporations (temporary).

(a) through (d)(2)(vi)(A) [Reserved].—For further guidance, see §1.367(a)–3(a) through (d)(2)(vi)(A).

(B) *Exceptions*. (*1*) If a transaction is described in paragraph (d)(2)(vi)(A) of this section, section 367(a) and (d) will not apply to the extent a domestic corporation (domestic acquired corporation) transfers assets to a foreign corporation (foreign acquiring corporation) in an asset reorganization, and those assets (re-transferred assets) are transferred to a domestic corporation (domestic controlled corporation) in a controlled asset transfer, provided that each of the following conditions is satisfied:

(*i*) The domestic controlled corporation's adjusted basis in the re-transferred assets is not greater than the domestic acquired corporation's adjusted basis in those assets. For this purpose, any increase in basis in the re-transferred assets that results because the domestic acquired corporation recognized gain or income with respect to the re-transferred assets in the transaction is not taken into account.

(*ii*) The domestic acquired corporation includes a statement described in paragraph (d)(2)(vi)(C) of this section with its U.S. income tax return for the taxable year of the transfer; and

(*iii*) The requirements of paragraphs (c)(1)(i), (c)(1)(ii), (c)(1)(iv), and (c)(6) of this section are satisfied with respect to the indirect transfer of stock in the domestic acquired corporation.

(*2*) Sections 367(a) and (d) shall not apply to transfers described in paragraph (d)(1)(vi) of this section if a U.S. person transfers assets to a foreign corporation in a section 351 exchange, to the extent that such assets are transferred by such foreign corporation to a domestic corporation in another section 351 exchange, but only if the domestic transferee's adjusted basis in the assets is not greater than the adjusted basis that the U.S. person had in such assets. Any increase in adjusted basis in the assets that results because the U.S. person recognized gain or income with respect to such assets in the initial section 351 exchange is not taken into account for purposes of determining whether the domestic transferee's adjusted basis in the assets is not greater than the U.S. person's adjusted basis in such assets. This paragraph (d)(2)(vi)(B)(*2*) will not, however, apply to an exchange described in section 351 that is also an exchange described in section 361(a) or (b). An exchange described in section 351 that is also an exchange described in section 361(a) or (b) is only eligible for the exception in paragraph (d)(2)(vi)(B)(*1*) of this section.

(C) through (d)(3), *Example 6A* [Reserved]. For further guidance, see §1.367(a)–3(d)(2)(vi)(C) through (d)(3), *Example 6A*.

Example 6B. Section 368(a)(1)(C) reorganization followed by a controlled asset transfer to a domestic controlled corporation—(i) *Facts*. The facts are the same as in paragraph (d)(3), *Example 6A* of this section, except that R is a domestic corporation.

(ii) *Result*. As in paragraph (d)(3) *Example 6A* of this section, the outbound transfer of the Business A assets to F is not affected by the rules of §1.367–3(d) and is subject to the general rules under section 367. Subject to the conditions and requirements of section 367(a)(5) and §1.367(a)–7(c), the Business A assets qualify for the section 367(a)(3) active trade or business exception and are not subject to section 367(a)(1). The Business B and C assets are part of an indirect stock transfer under §1.367–3(d), but must first be tested under section 367(a) and (d). The Business B assets qualify for the active trade or business exception under section 367(a)(3); the Business C assets do not. However, pursuant to paragraph (d)(2)(vi)(B)(*1*) of this section, the Business B and C assets are not subject to section 367(a) or (d), provided that the basis of the Business B and C assets in the hands of R is not greater than the basis of the assets in the hands of Z, the requirements of paragraphs (c)(1)(i), (c)(1)(ii), (c)(1)(iv), and (c)(6) of this section are satisfied, and Z attaches a statement described in paragraphs (d)(2)(vi)(C) of this section to its U.S. income tax return for the taxable year of the transfer. V also is deemed to make an indirect transfer of Z stock under the rules of paragraph (d) of this section to the extent the assets are transferred to R. To preserve non-recognition treatment, and assuming the other requirements of paragraph (c) of this section are satisfied, V must enter into a gain recognition agreement in the amount of $50, which equals the aggregate gain in the Business B and C assets, because the transfer of those assets by Z was not taxable under section 367(a)(1) and constitute an indirect stock transfer.

Example 6C. Section 368(a)(1)(C) reorganization followed by a controlled asset transfer to a domestic controlled corporation—(i) *Facts*. The facts are the same as in *Example 6B*, except that Z is owned by U.S. individuals, none of whom qualify as five-percent target shareholders with respect to Z within the meaning of paragraph (c)(5)(iii) of this section. The following additional facts are present. No U.S. persons that are either officers or directors of Z own any stock of F immediately after the transfer. F is engaged in an active trade or business outside the United States that satisfies the test set forth in paragraph (c)(3) of this section.

(ii) *Result*. The Business A assets transferred to F are not re-transferred to R and therefore Z's transfer of these assets is not subject to the rules of paragraph (d) of this section. However, gain must be recognized on the transfer of those assets under section 367(a)(1) because the section 367(a)(3) active trade or business exception is inapplicable pursuant to section 367(a)(5) and §1.367(a)–7(b). The Business B and C assets are part of an indirect stock transfer under paragraph (d) of this section, but must first be tested with respect to Z under section 367(a) and (d), as provided in paragraph (d)(2)(vi) of this section. The transfer of the Business B assets (which otherwise would satisfy the section 367(a)(3) active trade or business exception) generally is subject to section 367(a)(1) pursuant to section 367(a)(5) and §1.367(a)–7(b). The transfer of the Business C assets generally is subject to section 367(a)(1) because these assets do not qualify for the active trade or business exception under section 367(a)(3). However, pursuant to paragraph (d)(2)(vi)(B) of this section, the transfer of the Business B and C assets is not subject to sections 367(a)(1) and (d), provided the basis of the Business B and C assets in the hands of R is no greater than the basis in the hands of Z and certain other requirements are satisfied. Z may avoid immediate gain recognition under section 367(a) and (d) on the transfers of the Business B and Business C assets to F if, pursuant to paragraph (d)(2)(vi)(B) of this section, the indirect transfer of Z stock satisfies the requirements of paragraphs (c)(1)(i), (c)(1)(ii), (c)(1)(iv), and (c)(6) of this section, and Z attaches a statement described in paragraph (d)(2)(vi)(C) of this section to its U.S. income tax return for the taxable year of the transfer. In general, the statement must contain a certification that, if F disposes of the stock of R (in a recognition or nonrecognition transaction) and a principal purpose of the transfer is the avoidance of U.S. tax that would have been imposed on Z on the disposition of the Business B and C assets transferred to R, then Z (or F on behalf of Z) will file a return (or amended return as the case may be) recognizing gain ($50), as if, immediately prior to the reorganization, Z transferred the Business B and C assets to a domestic corporation in exchange for stock in a transaction treated as a section 351 exchange and immediately sold such stock to an unrelated party for its fair market value. A transaction is deemed to have a principal purpose of U.S. tax avoidance if F disposes of R stock within two years of the transfer, unless Z (or F on behalf of Z) can rebut the presumption to the satisfaction of the Commissioner. See paragraph (d)(2)(vi)(D)(*2*) of this section. With respect to the indirect transfer of Z stock, assume the requirements of paragraphs (c)(1)(i), (c)(1)(ii), and (c)(1)(iv) of this section are satisfied. Thus, assuming Z attaches the statement described in paragraph (d)(2)(vi)(C) of this section to its U.S. income tax return and satisfies the reporting requirements of paragraph (c)(6) of this section, the transfer of Business B and C assets is not subject to immediate gain recognition under section 367(a) or (d).

Example 7 through *Example 8(C)* [Reserved]. For further guidance, see §1.367(a)–3(d)(3), *Example 7* through (d)(3), *Example 8(C)*.

Example 9. Indirect stock transfer by reason of a controlled asset transfer—(i) *Facts*. The facts are the same as in paragraph (d)(3) *Example 8* of this section, except that R transfers the Business A assets to M, a wholly owned domestic subsidiary of R, in a controlled asset transfer. In addition, V's basis in its Z stock is $90.

(ii) *Result*. Pursuant to paragraph (d)(2)(vi)(B) of this section, sections 367(a) and (d) do not apply to Z's transfer of the Business A assets to R if M's basis in the Business A assets is not greater than the basis of the assets in the hands of Z, the requirements of paragraphs (c)(1)(i), (c)(1)(ii), (c)(1)(iv), and (c)(6) of this section are satisfied, and Z includes a statement described in paragraph (d)(2)(vi)(C) of this section with its U.S. income tax return for the taxable year of the transfer. Subject to the conditions and requirements of section 367(a)(5) and §1.367(a)–7(c), Z's transfer of the Business B assets to R (which are not re-transferred to M) qualifies for the active trade or business exception under section 367(a)(3). Pursuant to paragraphs (d)(1) and (d)(2)(vii)(A)(*1*) of this section, V is generally deemed to transfer the stock of a foreign corporation to F in a section 354 exchange subject to the rules of paragraphs (b) and (d) of this section, including the requirement that V enter into a gain recognition agreement and comply with the requirements of §1.367(a)–8. However, pursuant to paragraph (d)(2)(vii)(B), paragraph (d)(2)(vii)(A) of this section does not apply to the extent of the transfer of business A assets by R to M, a domestic corporation. As a result, to the extent of the business A assets transferred by R to M, V is deemed to transfer the stock of Z (a domestic corporation) to F in a section 354 exchange subject to the rules of paragraphs (c) and (d) of this section. Thus, with respect to V's indirect transfer of stock of a domestic corporation to F, such transfer is not subject to gain recognition under section 367(a)(1) if the requirements of paragraph (c) of this section are satisfied, including the requirement that V enter into a gain recognition agreement (separate from the gain recognition agreement described above with respect to the deemed transfer of stock of a foreign corporation to F) and comply with the requirements of §1.367(a)–8. Under paragraphs (d)(2)(i) and (d)(2)(ii) of this section, the transferee foreign corporation is F and the transferred corporation is R (with respect to the transfer of stock of a foreign corporation) and M (with respect to the transfer of stock of a domestic corporation). Pursuant to paragraph (d)(2)(iv) of this section, a disposition by F of the stock of R would trigger both gain recognition agreements. In addition, a disposition by R of the stock of M would trigger the gain recognition agreement filed with respect to the transfer of the stock of a domestic corporation. To determine whether there is a triggering event under §1.367(a)–8(j)(2)(i) for the gain recognition agreement filed with respect to the transfer of stock of the domestic corporation, the Business A assets in M must be considered. To determine whether there is such a triggering event for the gain recognition agreement filed with respect to the transfer of stock of the foreign corporation, the Business B assets in R must be considered.

Example 10 through *Example 16* [Reserved]. For further guidance, see §1.367(a)–3(d)(3), *Example 10* through *Example 16*.

(e) *Transfers of stock or securities by a domestic corporation to a foreign corporation in a section 361 exchange*—(1) *Overview*—(i) *Scope and definitions*. This paragraph (e) applies to a domestic corporation (U.S. transferor) that transfers stock or securities of a domestic or foreign corporation (transferred stock or securities) to a foreign corporation (foreign acquiring corporation) in a section 361 exchange. Except as otherwise provided in this paragraph (e), paragraphs (b) and (c) of this section do not apply to the U.S. transferor's transfer of the transferred stock or securities in the section 361 exchange. For purposes of this paragraph (e), the definitions of *control group*, *control group member*, and *non-control group member* in §1.367(a)–7(f)(1), *ownership interest percentage* in §1.367(a)–7(f)(7), *section 361 exchange* in §1.367(a)–7(f)(8), and *U.S. transferor shareholder* in §1.367(a)–7(f)(13), shall apply.

(ii) *Ordering rules*. Except as otherwise provided, this paragraph (e) shall apply to the transfer of the transferred stock or securities in the section 361 exchange prior to the application of any other provision of section 367 to such transfer. Furthermore, any gain recognized (including gain treated as a deemed dividend pursuant to section 1248(a)) by the U.S. transferor under this paragraph (e) shall be taken into account for purposes of applying any other provision of section 367 (including §§1.367(a)–6T, 1.367(a)–7, and 1.367(b)–4) to the transfer of the transferred stock or securities.

(2) *General rule*. Except as provided in paragraph (e)(3) of this section, the transfer by the U.S. transferor of the transferred stock or securities to the foreign acquiring corporation in the section 361 exchange shall be subject to section 367(a)(1), and therefore the U.S. transferor shall recognize any gain (but not loss) realized with respect to the transferred stock or securities. Realized gain is recognized pursuant to the prior sentence notwithstanding that the transfer is described in any other nonrecognition provision enumerated in section 367(a)(1) (such as section 351 or 354).

(3) *Exception*. The general rule of paragraph (e)(2) of this section shall not apply if the conditions of paragraphs (e)(3)(i), (e)(3)(ii), and (e)(3)(iii) of this section are satisfied.

(i) The conditions set forth in §1.367(a)–7(c) are satisfied with respect to the section 361 exchange.

(ii) If the transferred stock or securities are of a domestic corporation, the U.S. target company (as defined in paragraph (c)(1) of this section) complies with the reporting requirements of paragraph (c)(6) of this section, and the conditions of paragraphs (c)(1)(i), (c)(1)(ii), and (c)(1)(iv) of this section are satisfied with respect to the transferred stock or securities.

(iii) If the U.S. transferor owns (applying the attribution rules of section 318, as modified by section 958(b)) five percent or more of the total voting power or the total value of the stock of the transferee foreign corporation immediately after the transfer of the transferred stock or securities in the section 361 exchange, then the conditions set forth in paragraphs (e)(3)(iii)(A), (e)(3)(iii)(B), and (e)(3)(iii)(C) of this section are satisfied.

(A) Except as otherwise provided in this paragraph (e)(3)(iii)(A), each U.S. transferor shareholder that is a qualified U.S. person (as defined in paragraph (e)(6)(vii) of this section) owning (applying the attribution rules of section 318, as modified by section 958(b)) five percent or more of the total voting power or the total value of the stock of the transferee foreign corporation immediately after the reorganization enters into a gain recognition agreement that satisfies the conditions of paragraph (e)(6) of this section and §1.367(a)–8. A U.S. transferor shareholder is not required to enter into a gain recognition agreement pursuant to this paragraph if the amount of gain that would be subject to the gain recognition agreement (as determined under paragraph (e)(6)(i) of this section) is zero.

(B) With respect to non-control group members that are not described in paragraph (e)(3)(iii)(A) of this section, the U.S. transferor recognizes gain equal to the product of the aggregate ownership interest percentage of such non-control group members multiplied by the gain realized by the U.S. transferor on the transfer of the transferred stock or securities.

(C) With respect to each control group member that is not described in paragraph (e)(3)(iii)(A) of this section, the U.S. transferor recognizes gain equal to the product of the ownership interest percentage of such control group member multiplied by the gain realized by the U.S. transferor on the transfer of the transferred stock or securities.

(4) *Application of certain rules at U.S. transferor-level*. For purposes of paragraphs (c)(5)(iii), (e)(3)(ii), and (e)(3)(iii) of this section, ownership of the stock of the transferee foreign corporation is determined by reference to stock owned by the U.S. transferor immediately after the transfer of the transferred stock or securities to the foreign acquiring corporation in the section 361 exchange, but prior to and without taking into account the U.S. transferor's distribution under section 361(c)(1) of the stock received.

(5) *Transferee foreign corporation*—(i) *General rule*. Except as provided in paragraph (e)(5)(ii) of this section, the transferee foreign corporation for purposes of applying paragraph (e) of this section and §1.367(a)–8 shall be the foreign corporation that issues stock or securities to the U.S. transferor in the section 361 exchange.

(ii) *Special rule for triangular asset reorganizations involving the receipt of stock or securities of a domestic corporation*. In the case of a triangular asset reorganization described in §§1.358–(6)(b)(2)(i), (b)(2)(ii) or (b)(2)(iii), or §1.358–6(b)(2)(v) (triangular asset reorganization) in which the U.S. transferor receives stock or securities of a domestic corporation that is in control (within the meaning of section 368(c)) of the foreign acquiring corporation, the transferee foreign corporation shall be the foreign acquiring corporation.

(6) *Special requirements for gain recognition agreements*. A gain recognition agreement filed by a U.S. transferor shareholder pursuant to paragraph (e)(3)(iii)(A) of this section is, in addition to the terms and conditions of §1.367(a)–8, subject to the conditions of this section (e)(6).

(i) The amount of gain subject to the gain recognition agreement shall equal the product of the ownership interest percentage of the U.S. transferor shareholder multiplied by the gain realized by the U.S. transferor on the transfer of the transferred stock or securities, reduced (but not below zero) by the sum of the amounts described in paragraphs (e)(6)(i)(A), (e)(6)(i)(B), (e)(6)(i)(C), and (e)(6)(i)(D) of this section.

(A) Gain recognized by the U.S. transferor with respect to the transferred stock or securities under section 367(a)(1) (including any portion treated as a deemed dividend under section 1248(a)) that is attributable to such U.S. transferor shareholder pursuant to §1.367(a)–7(c)(2) or §1.367(a)–7(e)(5).

(B) A deemed dividend included in the income of the U.S. transferor with respect to the transferred stock under §1.367(b)–4(b)(1)(i) that is attributable to such U.S. transferor shareholder pursuant to §1.367(a)–7(e)(4).

(C) If the U.S. transferor shareholder is subject to an election under §1.1248(f)–2(c)(1), a deemed dividend included in the income of the U.S. transferor pursuant to §1.1248(f)–2(c)(3) that is attributable to the U.S. transferor shareholder.

(D) If the U.S. transferor shareholder is not subject to an election under §1.1248(f)–2(c)(1), the hypothetical section 1248 amount (as defined in §1.1248(f)–1(c)(4)) with respect to the stock of each foreign corporation transferred in the section 361 exchange attributable to the U.S. transferor shareholder.

(ii) The gain recognition agreement shall include the election described in §1.367(a)–8(c)(2)(vi).

(iii) The gain recognition agreement shall designate the U.S. transferor shareholder as the U.S. transferor for purposes of §1.367(a)–8.

(iv) If the transfer of the transferred stock or securities in the section 361 exchange is pursuant to a triangular asset reorganization, the gain recognition agreement shall include appropriate provisions that are consistent with the principles of §1.367(a)–8 for gain recognition agreements involving multiple parties. See §1.367(a)–8(j)(9).

(v) The gain recognition agreement shall not be eligible for termination upon a taxable disposition pursuant to §1.367(a)–8(o)(1) unless the value of the stock or securities received by the U.S. transferor shareholder in exchange for the stock or securities of the U.S. transferor under section 354 or 356 is at least equal to the amount of gain subject to the gain recognition agreement filed by such U.S. transferor shareholder.

(vi) Except as otherwise provided in this paragraph (e)(6)(vi), if gain is subsequently recognized by the U.S. transferor shareholder under the terms of the gain recognition agreement pursuant to §1.367(a)–8(c)(1)(i), the increase in stock basis provided under §1.367(a)–8(c)(4)(i) with respect to the stock received by the U.S. transferor shareholder shall not exceed the amount of the stock basis adjustment made pursuant to §1.367(a)–7(c)(3) with respect to the stock received by the U.S. transferor shareholder. This paragraph (e)(6)(vi) shall not apply if the U.S. transferor shareholder and the U.S. transferor are members of the same consolidated group at the time of the reorganization.

(vii) For purposes of this section, a *qualified U.S. person* means a U.S. person, as defined in §1.367(a)–1T(d)(1), but for this purpose does not include domestic partnerships, regulated investment companies (as defined in section 851(a)), real estate investment trusts (as defined in section 856(a)), and S corporations (as defined in section 1361(a)).

(7) *Gain subject to section 1248(a).* If the U.S. transferor recognizes gain under paragraphs (e)(3)(iii)(B) or (e)(3)(iii)(C) of this section with respect to transferred stock that is stock in a foreign corporation to which section 1248(a) applies, then the portion of such gain treated as a deemed dividend under section 1248(a) is the product of the amount of the gain multiplied by the section 1248(a) ratio. The section 1248(a) ratio is the ratio of the amount that would be treated as a deemed dividend under section 1248(a) if all the gain in the transferred stock were recognized to the amount of gain realized in all the transferred stock.

(8) *Examples.* The following examples illustrate the provisions of paragraph (e) of this section. Except as otherwise indicated: US1, US2, and UST are domestic corporations that are not members of a consolidated group; X is a United States citizen; US1, US2, and X are unrelated parties; CFC1, CFC2, and FA are foreign corporations; each corporation described herein has a single class of stock issued and outstanding and a tax year ending on December 31; the section 1248 amount (within the meaning of §1.367(b)–2(c)) with respect to the stock of CFC1 and CFC2 is zero; Asset A is section 367(a) property that, but for the application of section 367(a)(5), would qualify for the active foreign trade or business exception under §1.367(a)–2T; the requirements of §1.367(a)–7(c)(2) through 1.367(a)–7(c)(5) are satisfied with respect to a section 361 exchange; the provisions of §1.367(a)–6T (regarding branch loss recapture) are not applicable; and none of the foreign corporations in the examples is a surrogate foreign corporation (within the meaning of section 7874) as a result of the transactions described in the examples because one or more of the conditions of section 7874(a)(2)(B) is not satisfied.

Example 1. U.S. transferor owns less than 5% of stock of transferee foreign corporation. (i) *Facts.* US1, US2, and X own 80%, 5%, and 15%, respectively, of the stock of UST with a fair market value of $160x, $10x, and $30x, respectively. UST has two assets, Asset A and 100% of the stock of CFC1. UST has no liabilities. Asset A has a $150x basis and $100x fair market value (as defined in §1.367(a)–7(f)(3)), and the CFC1 stock has a $0x basis and $100x fair market value. UST transfers Asset A and the CFC1 stock to FA solely in exchange for $200x of FA voting stock in a reorganization described in section 368(a)(1)(C). UST's transfer of Asset A and the CFC1 stock to FA qualifies as a section 361 exchange. UST distributes the FA stock received in the section 361 exchange to US1, US2, and X pursuant to the plan of reorganization, and liquidates. US1 receives $160x of FA stock, US2 receives $10x of FA stock, and X receives $30x of FA stock in exchange for the UST stock. Immediately after the transfer of Asset A and the CFC1 stock to FA in the section 361 exchange, but prior to and without taking into account UST's distribution of the FA stock pursuant to section 361(c)(1), UST does not own (applying the attribution rules of section 318, as modified by section 958(b)) five percent or more of the total voting power or the total value of the stock of FA.

(ii) *Result.* (A) UST's transfer of the CFC1 stock to FA in the section 361 exchange is subject to the provisions of this paragraph (e), and this paragraph (e) applies to the transfer of the CFC1 stock prior to the application of any other provision of section 367 to such transfer. See paragraphs (e)(1)(i) and (e)(1)(ii) of this section. Pursuant to the general rule of paragraph (e)(2) of this section, UST must recognize the gain realized of $100x on the transfer of the CFC1 stock (computed as the excess of the $100x fair market value over the $0x basis) unless the requirements for the exception provided in paragraph (e)(3) of this section are satisfied. In this case, the requirements of paragraph (e)(3) of this section are satisfied. First, the requirement of paragraph (e)(3)(i) of this section is satisfied because the control requirement of §1.367(a)–7(c)(1) is satisfied, and a stated assumption is that the requirements of §§1.367(a)–7(c)(2) through 1.367(a)–7(c)(5) will be satisfied. The control requirement is satisfied because US1 and US2, each a control group member, own in the aggregate 85% of the stock of UST immediately before the reorganization. Second, the requirement of paragraph (e)(3)(ii) of this section is not applicable because that paragraph applies to the transfer of stock of a domestic corporation and CFC1 is a foreign corporation. Third, paragraph (e)(3)(iii) of this section is not applicable because immediately after the section 361 exchange, but prior to and without taking into account UST's distribution of the FA stock pursuant to section 361(c)(1), UST does not own (applying the attribution rules of section 318, as modified by section 958(b)) 5% or more of the total voting power or the total value of the stock of FA. See paragraph (e)(4) of this section. Accordingly, UST does not recognize the $100x of gain realized in the CFC1 stock pursuant to this section.

(B) In order to meet the requirements of §1.367(a)–7(c)(2)(i), UST must recognize gain equal to the portion of the inside gain (as defined in §1.367(a)–7(f)(5)) attributable to non-control group members (X), or $7.50x. The $7.50x of gain is computed as the product of the inside gain ($50x) multiplied by X's ownership interest percentage in UST (15%). Pursuant to §1.367(a)–7(f)(5), the $50x of inside gain is the amount by which the aggregate fair market value ($200x) of the section 367(a) property (as defined in §1.367(a)–7(f)(10), or Asset A and the CFC1 stock) exceeds the sum of the inside basis ($150x) of such property and the product of the section 367(a) percentage (as defined in §1.367(a)–7(f)(9), or 100%) multiplied by UST's deductible liabilities (as defined in §1.367(a)–7(f)(2), or $0x). Pursuant to §1.367(a)–7(f)(4), the inside basis equals the aggregate basis of the section 367(a) property transferred in the section 361 exchange ($150x), increased by any gain or deemed dividends recognized by UST with respect to the section 367(a) property under section 367 ($0x), but not including the $7.50x of gain recognized by UST under §1.367(a)–7(c)(2)(i). Pursuant to §1.367(a)–7(e)(1), the $7.50x of gain recognized by UST is treated as recognized with respect to the CFC1 stock and Asset A in proportion to the amount of gain realized in each. However, because there is no gain realized by UST with respect to Asset A, all $7.50x of the gain is allocated to the CFC1 stock. Furthermore, FA's basis in the CFC1 stock, as determined under section 362 is increased by the $7.50x of gain recognized by UST. See §1.367(a)–1(b)(4)(i)(B).

(C) The requirement to recognize gain under §1.367(a)–7(c)(2)(ii) is not applicable because the portion of the inside gain attributable to US1 and US2 (control group members) can be preserved in the stock received by each such shareholder. As described in paragraph (ii)(B) of this *Example 1*, the inside gain is $50x. US1's attributable inside gain of $40x (equal to the product of $50x inside gain multiplied by US1's 80% ownership interest percentage, reduced by $0x, the sum of the amounts described in §1.367(a)–7(c)(2)(ii)(A)(*1*) through (c)(2)(ii)(A)(*3*)) does not exceed $160x (equal to the product of the section 367(a) percentage of 100% multiplied by $160x fair market value of FA stock received by US1). Similarly, US2's attributable inside gain of $2.50x (equal to the product of $50x inside gain multiplied by US2's 5% ownership interest percentage, reduced by $0x, the sum of the amounts described in §1.367(a)–7(c)(2)(ii)(A)(*1*) through (c)(2)(ii)(A)(*3*))) does not exceed $10x (equal to the product of the section 367(a) percentage of 100% multiplied by $10x fair market value of FA stock received by US2).

(D) Each control group member (US1 and US2) must separately compute any required adjustment to stock basis under §1.367(a)–7(c)(3).

Example 2. U.S. transferor owns 5% or more of the stock of the transferee foreign corporation. (i) *Facts*. The facts are the same as in *Example 1*, except that immediately after the section 361 exchange, but prior to and without taking into account UST's distribution of the FA stock pursuant to section 361(c)(1), UST owns (applying the attribution rules of section 318, as modified by section 958(b)) 5% or more of the total voting power or value of the stock of FA. Furthermore, immediately after the reorganization, US1 and X (but not US2) each own (applying the attribution rules of section 318, as modified by section 958(b)) five percent or more of the total voting power or value of the stock of FA.

(ii) *Result*. (A) As is the case with *Example 1*, UST's transfer of the CFC1 stock to FA in the section 361 exchange is subject to the provisions of this paragraph (e), and this paragraph (e) applies to the transfer of the CFC1 stock prior to the application of any other provision of section 367 to such transfer. See paragraphs (e)(1)(i) and (e)(1)(ii) of this section. In addition, UST must recognize the gain realized of $100x on the transfer of the CFC1 stock (computed as the excess of the $100x fair market value over the $0x basis) unless the requirements for the exception provided in paragraph (e)(3) of this section are satisfied. For the same reasons provided in *Example 1*, the requirement in paragraph (e)(3)(i) of this section is satisfied and the requirement of paragraph (e)(3)(ii) of this section is not applicable.

(B) Unlike *Example 1*, however, UST owns 5% or more of the voting power or value of the stock of FA immediately after the transfer of the CFC1 stock in the section 361 exchange, but prior to and without taking into account UST's distribution of the FA stock under section 361(c)(1). As a result, paragraph (e)(3)(iii) of this section is applicable to the section 361 exchange of the CFC1 stock. Accordingly, in order to meet the requirements of paragraph (e)(3)(iii)(A) of this section US1 and X must enter into gain recognition agreements that satisfy the requirements of paragraph (e)(6) of this section and §1.367(a)–8. See paragraph (ii)(G) of this *Example 2* for the computation of the amount of gain subject to each gain recognition agreement.

(C) In order to meet the requirements of paragraph (e)(3)(iii)(C) of this section, UST must recognize $5x of gain attributable to US2 (computed as the product of the $100x of gain realized with respect to the transfer of the CFC1 stock multiplied by the 5% ownership interest percentage of US2). The $5x of gain recognized is not included in the computation of inside basis (see §1.367(a)–7(f)(4)(i)), but reduces (but not below zero) the amount of gain recognized by UST pursuant to §1.367(a)–7(c)(2)(ii) that is attributable to US2. Furthermore, FA's basis in the CFC1 stock as determined under section 362 is increased for the $5x of gain recognized. See §1.367(a)–1(b)(4)(i)(B). Assuming US1 and X enter into the gain recognition agreements described in paragraph (ii)(B) of this *Example* 2, and UST recognizes the $5x of gain described in this example, the requirements of paragraph (e)(3) are satisfied and, accordingly, UST does not recognize the remaining $95x of gain realized in the CFC1 stock pursuant to this section.

(D) As described in paragraph (ii)(B) of *Example 1*, UST must recognize $7.50x of gain pursuant to §1.367(a)–7(c)(2)(i), the amount of the $50x of inside gain attributable to X. Pursuant to §1.367(a)–7(e)(1), the $7.50x of gain recognized by UST is treated as recognized with respect to the CFC1 stock and Asset A in proportion to the amount of gain realized in each. However, because there is no gain realized by UST with respect to Asset A, all $7.50x of the gain is allocated to the CFC1 stock. Furthermore, FA's basis in the CFC1 stock as determined under section 362 is increased for the $7.50x of gain recognized. See §1.367(a)–1(b)(4)(i)(B).

(E) As described in paragraph (ii)(C) of *Example 1*, the requirement to recognize gain pursuant to §1.367(a)–7(c)(2)(ii) is not applicable because the attributable inside gain of US1 and US2 can be preserved in the stock received by each shareholder. However, if UST were required to recognize gain pursuant to §1.367(a)–7(c)(2)(ii) for inside gain attributable to US2 (for example, if US2 received solely cash rather than FA stock in the reorganization), the amount of such gain would be reduced (but not below zero) by the amount of gain recognized by UST pursuant to paragraph (e)(3)(iii)(C) of this section that is attributable to US2 (computed as $5x in paragraph (ii)(C) of this *Example 2*). See §1.367(a)–7(c)(2)(ii)(A)(*1*).

(F) Each control group member (US1 and US2) must separately compute any required adjustment to stock basis under §1.367(a)–7(c)(3).

(G) The amount of gain subject to the gain recognition agreement filed by each of US1 and X is determined pursuant to paragraph (e)(6)(i) of this section. With respect to US1, the amount of gain subject to the gain recognition agreement is $80x. The $80x is computed as the product of US1's ownership interest percentage (80%) multiplied by the gain realized by UST in the CFC1 stock as determined prior to taking into account the application of any other provision of section 367 ($100x), reduced by the sum of the amounts described in paragraphs (e)(6)(i)(A) through (e)(6)(i)(D) of this section attributable to US1 ($0x). With respect to X, the amount of gain subject to the gain recognition agreement is $7.50x. The $7.50x is computed as the product of X's ownership interest percentage (15%) multiplied by the gain realized by UST in the CFC1 stock as determined prior to taking into account the application of any other provision of section 367 ($100x), reduced by the sum of the amounts described in paragraphs (e)(6)(i)(A) through (e)(6)(i)(D) of this section attributable to X ($7.50x, as computed in paragraph (ii)(D) of this *Example 2*).

(H) In order the meet the requirements of paragraph (e)(6)(ii) of this section, each gain recognition agreement must include the election described in §1.367(a)–8(c)(2)(vi). Furthermore, pursuant to paragraph (e)(6)(iii) of this section, US1 and X must be designated as the U.S. transferor on their respective gain recognition agreements for purposes of §1.367(a)–8.

Example 3. U.S. transferor owns 5% or more of the stock of the transferee foreign corporation; interaction with section 1248(f). (i) *Facts*. US1, US2, and X own 50%, 30%, and 20%, respectively, of the stock of UST. The UST stock owned by US1 has a $180x basis and $200x fair market value; the UST stock owned by US2 has a $100x basis and $120x fair market value; and the UST stock owned by X has a $80x fair market value. UST owns Asset A, and all the stock of CFC1 and CFC2. UST has no liabilities. Asset A has a $10x basis and $200x fair market value. The CFC1 stock is a single block of stock (as defined in §1.1248(f)–1(c)(2)) with a $20x basis, $40x fair market value, and $30x of earnings and profits attributable to it for purposes of section 1248 (with the result that the section 1248 amount (as defined in §1.1248(f)–1(c)(9)) is $20x). The CFC2 stock is also a single block of stock with a $30x basis, $160x fair market value, and $150x of earnings and profits attributable to it for purposes of section 1248 (with the result that the section 1248 amount is $130x). On December 31, Year 3, in a reorganization described in section 368(a)(1)(D), UST transfers the CFC1 stock, CFC2 stock, and Asset A to FA in exchange for 60 shares of FA stock with a $400x fair market value. UST's transfer of the CFC1 stock, CFC2 stock, and Asset A to FA in exchange for the 60 shares of FA stock qualifies as a section 361 exchange. UST distributes the FA stock received in the section 361 exchange to US1, US2, and X pursuant to section 361(c)(1). US1, US2, and X exchange their UST stock for 30, 18, and 12 shares, respectively, of FA stock pursuant to section 354. Immediately after the reorganization, FA has 100 shares of stock outstanding, and US1 and US2 are each a section 1248 shareholder with respect to FA.

(ii) *Result*. (A) UST's transfer of the CFC1 stock and CFC2 stock to FA in the section 361 exchange is subject to the provisions of this paragraph (e), and this paragraph (e) applies to the transfer of the CFC1 stock and CFC2 stock prior to the application of any other provision of section 367 to such transfer. See paragraphs (e)(1)(i) and (e)(1)(ii) of this section. Pursuant to the general rule of paragraph (e)(2) of this section, UST must recognize the gain realized of $20x on the transfer of the CFC1 stock (the excess of $40x fair market value over $20x basis) and the gain realized of $130x on the transfer of the CFC2 stock (the excess of $160x fair market value over $30x basis), subject to the application of section 1248(a), unless the requirements for the exception provided in paragraph (e)(3) of this section are satisfied. In this case, the requirement of paragraph (e)(3)(i) of this section is satisfied because the control requirement of §1.367(a)–7(c)(1) is satisfied, and a stated assumption is that the requirements of §§1.367(a)–7(c)(2) through 1.367(a)–7(c)(5) will be satisfied. The control requirement is satisfied because US1 and US2, each a control group member, own in the aggregate 80% of the UST stock immediately before the reorganization. The requirement of paragraph (e)(3)(ii) of this section is not applicable because that paragraph applies to the transfer of stock of a domestic corporation, and CFC1 and CFC2 are foreign corporations. UST owns 5% or more of the total voting power or value of the stock of FA (60%, or 60 of the 100 shares of FA stock outstanding) immediately after the transfer of the CFC1 stock and CFC2 stock in the section 361 exchange, but prior to and without taking into account UST's distribution of the FA stock under section 361(c)(1). As a result, paragraph (e)(3)(iii) of this section is applicable to the section 361 exchange of the CFC1 stock and CFC2 stock. US1, US2, and X each own (applying the attribution rules of section 318, as modified by section 958(b)) 5% or more of the total voting power or value of the FA stock immediately after the reorganization, or 30%, 18%, and 12%, respectively. Accordingly, in order to meet the requirements of paragraph (e)(3)(iii)(A) of this section, US1 and US2 must enter into gain recognition agreements with respect to the CFC1 stock and CFC2 stock that satisfy the requirements of paragraph (e)(6) of this section and §1.367(a)–8. X is not required to enter into a gain recognition agreement because the amount of gain that would be subject to the gain recognition agreement is zero. See paragraph (ii)(J) of this *Example 3* for the computation of the amount of gain subject to each gain recognition agreement. Assuming US1 and US2 enter into the gain recognitions agreements described above, the requirements of paragraph (e)(3) are satisfied and accordingly, UST does not recognize the gain realized of $20x in the stock of CFC1 or the gain realized of $130x in the stock of CFC2 pursuant to this section.

(B) UST's transfer of the CFC1 stock and CFC2 stock to FA pursuant to the section 361 exchange is subject to §1.367(b)–4(b)(1)(i), which applies prior to the application of §1.367(a)–7(c). See paragraph (e)(1) of this section. UST (the exchanging shareholder) is a U.S. person and a section 1248 shareholder with respect to CFC1 and CFC2 (each a foreign acquired corporation). However, UST is not required to include in income as a deemed dividend the section 1248 amount with respect to the CFC1 stock ($20x) or CFC2 stock ($130x) under §1.367(b)–4(b)(1)(i) because, immediately after UST's section 361 exchange of the CFC1 stock and CFC2 stock for FA stock (and before the distribution of the FA stock to US1, US2, and X under section 361(c)(1), FA, CFC1, and CFC2 are controlled foreign corporations as to which UST is a section 1248 shareholder. See §1.367(b)–4(b)(1)(ii)(A). However, if UST were required to include in income as a deemed dividend the section 1248 amount with respect to the CFC1 stock or CFC2 stock (for example, if FA were not a controlled foreign corporation), such deemed dividend would be taken into account prior to the application of §1.367(a)–7(c). Furthermore, because US1, US2, and X are all persons described in paragraph (e)(3)(iii)(A) of this section, any such deemed dividend would increase inside basis. See §1.367(a)–7(f)(4).

(C) In order to meet the requirements of §1.367(a)–7(c)(2)(i), UST must recognize gain equal to the portion of the inside gain attributable to non-control group members (X), or $68x. The $68x of gain is computed as the product of the inside gain ($340x) multiplied by X's ownership interest percentage in UST (20%), reduced (but not below zero) by $0x, the sum of the amounts described in §1.367(a)–7(c)(2)(i)(A) through (c)(2)(i)(C). Pursuant to §1.367(a)–7(f)(5), the $340x of inside gain is the amount by which the aggregate fair market value ($400x) of the section 367(a) property (Asset A, CFC1 stock, and CFC2 stock) exceeds the sum of the inside basis ($60x) and $0x (the product of the section 367(a) percentage (100%) multiplied by UST's deductible liabilities ($0x)). Pursuant to §1.367(a)–7(f)(4), the inside basis equals the aggregate basis of the section 367(a) property transferred in the section 361 exchange ($60x), increased by any gain or deemed dividends recognized by UST with respect to the section 367(a) property under section 367 ($0x), but not including the $68x of gain recognized by UST under §1.367(a)–7(c)(2)(i). Under §1.367(a)–7(e)(1), the $68x gain recognized is treated as being with respect to the CFC1 stock, CFC2 stock, and Asset A in proportion to the amount of gain realized by UST on the transfer of the property. The amount treated as recognized with respect to the CFC1 stock is $4x ($68x gain multiplied by $20x/$340x). The amount treated as recognized with respect to the CFC2 stock is $26x ($68x gain multiplied by $130x/$340x). The amount treated as recognized with respect to Asset A is $38x ($68x gain multiplied by $190x/$340x). Under section 1248(a), UST must include in gross income as a dividend the $4x gain recognized with respect to the CFC1 stock and the $26x gain recognized with respect to CFC2 stock. Furthermore, FA's basis in the CFC1 stock, CFC2 stock, and Asset A, as determined under section 362, is increased by the amount of gain recognized by UST with respect to such property. See §1.367(a)–1(b)(4)(i)(B). Thus, FA's basis in the CFC1 stock is $24x ($20x increased by $4x of gain), the CFC2 stock is $56x ($30x increased by $26x of gain), and Asset A is $48x ($10x increased by $38x of gain).

(D) The requirement to recognize gain under §1.367(a)–7(c)(2)(ii) is not applicable because the portion of the inside gain attributable to US1 and US2 (control group members) can be preserved in the stock received by each such shareholder. As described in paragraph (ii)(C) of this *Example 3*, the inside gain is $340x. US1's attributable inside gain of $170x (equal to the product of $340x inside gain multiplied by US1's 50% ownership interest percentage, reduced by $0x, the sum of the amounts described in §1.367(a)–7(c)(2)(ii)(A)(*1*) through (c)(2)(ii)(A)(*3*)) does not exceed $200x (equal to the product of the section 367(a) percentage of 100% multiplied by $200x fair market value of FA stock received by US1). Similarly, US2's attributable inside gain of $102x (equal to the product of $340x inside gain multiplied by US2's 30% ownership interest percentage, reduced by $0x, the sum of the amounts described in §1.367(a)–7(c)(2)(ii)(A)(*1*) through (c)(2)(ii)(A)(*3*)) does not exceed $120x (equal to the product of the section 367(a) percentage of 100% multiplied by $120x fair market value of FA stock received by US2).

(E) Each control group member (US1 and US2) separately computes any required adjustment to stock basis under §1.367(a)–7(c)(3). US1's section 358 basis in the FA stock received of $180x (equal to US1's basis in the UST stock exchanged) is reduced to preserve the attributable inside gain with respect to US1, less any gain recognized with respect to US1 under §1.367(a)–7(c)(2)(ii). Because UST does not recognize gain on the section 361 exchange with respect to US1 under §1.367(a)–7(c)(2)(ii) (as determined in paragraph (ii)(D) of this *Example 3*), the attributable inside gain of $170x with respect to US1 is not reduced under §1.367(a)–7(c)(3)(i)(A). US1's outside gain (as defined in §1.367(a)–7(f)(6)) in the FA stock is $20x, the product of the section 367(a) percentage (100%) multiplied by the $20x gain (equal to the difference between $200x fair market value and $180x section 358 basis in the FA stock). Thus, US1's $180x section 358 basis in the FA stock must be reduced by $150x (the excess of $170x attributable inside gain, reduced by $0x, over $20x outside gain) to $30x. Similarly, US2's section 358 basis in the FA stock received of $100x (equal to US2's basis in the UST stock exchanged) is reduced to preserve the attributable inside gain with respect to US2, less any gain recognized with respect to US2 under §1.367(a)–7(c)(2)(ii). Because UST does not recognize gain on the section 361 exchange with respect to US2 under §1.367(a)–7(c)(2)(ii) (as determined in paragraph (ii)(D) of this *Example 3*), the attributable inside gain of $102x with respect to US2 is not reduced under §1.367(a)–7(c)(3)(i)(A). US2's outside gain in the FA stock is $20x, the product of the section 367(a) percentage (100%) multiplied by the $20x gain (equal to the difference between $120x fair market value and $100x section 358 basis in FA stock). Thus, US2's $100x section 358 basis in the FA stock must be reduced by $82x (the excess of $102x attributable inside gain, reduced by $0x, over $20x outside gain) to $18x.

(F) UST's distribution of the FA stock to US1, US2, and X under section 361(c)(1) (new stock distribution) is subject to §1.1248(f)–1(b)(3). Except as provided in §1.1248(f)–2(c), under §1.1248(f)–1(b)(3) UST must include in gross income as a dividend the total section 1248(f) amount (as defined in §1.1248(f)–1(c)(14)). The total section 1248(f) amount is $120x, the sum of the section 1248(f) amount (as defined in §1.1248(f)–1(c)(10)) with respect to the CFC1 stock ($16x) and CFC2 stock ($104x). The $16x section 1248(f) amount with respect to the CFC1 stock is the amount that UST would have included in income as a dividend under §1.367(b)–4(b)(1)(i) with respect to the CFC1 stock if the requirements of §1.367(b)–4(b)(1)(ii)(A) had not been satisfied ($20x), reduced by the amount of gain recognized by UST under §1.367(a)–7(c)(2) allocable to the CFC1 stock and treated as a dividend under section 1248(a) ($4x, as described in paragraph (ii)(C) of this *Example 3*). Similarly, the section 1248(f) amount with respect to the CFC2 stock is $104x ($130x reduced by $26x).

(G) If, however, UST along with US1 and US2 (each a section 1248 shareholder of FA immediately after the distribution) elect to apply the provisions of §1.1248(f)–2(c) (as provided in §1.1248(f)–2(c)(1)), the amount that UST is required to include in income as a dividend under §1.1248(f)–1(b)(3) ($120x total section 1248(f) amount as computed in paragraph (ii)(F of this *Example 3*) is reduced by the sum of the portions of the section 1248(f) amount with respect to the CFC1 stock and CFC2 stock that is attributable (under the rules of §1.1248(f)–2(d)) to the FA stock distributed to US1 and US2. Assume that the election is made to apply §1.1248(f)–2(c).

(*1*) Under §1.1248(f)–2(d)(1), the portion of the section 1248(f) amount with respect to the CFC1 stock that is attributed to the 30 shares of FA stock distributed to US1 is equal to the hypothetical section 1248 amount (as defined in §1.1248(f)–1(c)(4)) with respect to the CFC1 stock that is attributable to US1's ownership interest percentage in UST. US1's hypothetical section 1248 amount with respect to the CFC1 stock is the amount that UST would have included in income as a deemed dividend under §1.367(b)–4(b)(1)(i) with respect to the CFC1 stock if the requirements of §1.367(b)–4(b)(1)(ii)(A) had not been satisfied ($20x) and that would be attributable to US1's ownership interest percentage in UST (50%), reduced by the amount of gain recognized by UST under §1.367(a)–7(c)(2) attributable to US1 and allocable to the CFC1 stock, but only to the extent such gain is treated as a dividend under section 1248(a) ($0x, as described in paragraphs (ii)(C) and (D) of this *Example 3*). Thus, US1's hypothetical section 1248 amount with respect to the CFC1 stock is $10x ($20x multiplied by 50%, reduced by $0x). The $10x hypothetical section 1248 amount is attributed *pro rata* (based on relative values) among the 30 shares of FA stock distributed to US1, and the attributable share amount (as defined in §1.1248(f)–2(d)(1)) is $.33x ($10x/30 shares). Similarly, US1's hypothetical section 1248 amount with respect to the CFC2 stock is $65x ($130x multiplied by 50%, reduced by $0x), and the attributable share amount is $2.17x ($65x/30 shares). Similarly, US2's hypothetical section 1248 amount with respect to the CFC1 stock is $6x ($20x multiplied by 30%, reduced by $0x), and the attributable share amount is also $.33x ($6x/18 shares). Finally, US2's hypothetical section 1248 amount with respect to the CFC2 stock is $39x ($130x multiplied by 30%, reduced by $0x), and the attributable share amount is also $2.17x ($39x/18 shares). Thus, the sum of the portion of the section 1248(f) amount with respect to the CFC1 stock and CFC2 stock attributable to shares of stock of FA distributed to US1 and US2 is $120x ($10x plus $65x plus $6x plus $39x).

(*2*) If the shares of FA stock are divided into portions, §1.1248(f)–2(d)(2) applies to attribute the attributable share amount to portions of shares of FA stock distributed to US1 and US2. Under §1.1248(f)–2(c)(2) each share of FA stock received by US1 (30 shares) and US2 (18 shares) is divided into three portions, one attributable to the single block of stock of CFC1, one attributable to the single block of stock of CFC2, and one attributable to Asset A. Thus, the attributable share amount of $.33x with respect to the CFC1 stock is attributed to the portion of each of the 30 shares and 18 shares of FA stock received by US1 and US2, respectively, that relates to the CFC1 stock. Similarly, the attributable share amount of $2.17x with respect to the CFC2 stock is attributed to the portion of each of the 30 shares and 18 shares of FA stock received by US1 and US2, respectively, that relates to the CFC2 stock.

(*3*) The total section 1248(f) amount ($120x) that UST is otherwise required to include in gross income as a dividend under §1.1248(f)–1(b)(3) is reduced by $120x, the sum of the portions of the section 1248(f) amount with respect to the CFC1 stock and CFC2 stock that are attributable to the shares of FA stock distributed to US1 and US2. Thus, the amount DC is required to include in gross income as a dividend under §1.1248(f)–1(b)(3) is $0x ($120x reduced by $120x).

(H) As stated in paragraph (ii)(G)(*2*) of this *Example 3*, under §1.1248(f)–2(c)(2) each share of FA stock received by US1 (30 shares) and US2 (18 shares) is divided into three portions, one attributable to the CFC1 stock, one attributable to the CFC2 stock, and one attributable to Asset A. Under §1.1248(f)–2(c)(4)(i), the basis of each portion is the product of US1's and US2's section 358 basis in the share of FA stock multiplied by the ratio of the section 362 basis of the property (CFC1 stock, CFC2 stock, or Asset A, as applicable) received by FA in the section 361 exchange to which the portion relates, to the aggregate section 362 basis of all property received by FA in the section 361 exchange. Under §1.1248(f)–2(c)(4)(ii), the fair market value of each portion is the product of the fair market value of the share of FA stock multiplied by the ratio of the fair market value of the property (CFC1 stock, CFC2 stock, or Asset A, as applicable) to which the portion relates, to the aggregate fair market value of all property received by FA in the section 361 exchange. The section 362 basis of the CFC1 stock, CFC2 stock, and Asset A is $24x, $56x, and $48x, respectively, for an aggregate section 362 basis of $128x. See paragraph (ii)(C) of this *Example 3*. The fair market value of the CFC1 stock, CFC2 stock, and Asset A is $40x, $160x, and $200x, for an aggregate fair market value of $400x. Furthermore, US1's 30 shares of FA stock have an aggregate fair market value of $200x and section 358 basis of $30x (resulting in aggregate gain of $170x), and US2's 18 shares of FA stock have an aggregate fair market value of $120x and section 358 basis of $18x (resulting in aggregate gain of $102x). See paragraph (ii)(E) of this *Example 3*.

(*1*) With respect to US1's 30 shares of FA stock, the portions attributable to the CFC1 stock have an aggregate basis of $5.63x ($30x multiplied by $24x/$128x) and fair market value of $20x ($200x multiplied by $40x/$400x), resulting in aggregate gain in such portions of $14.38x (or $.48x gain in each such portion of the 30 shares). The portions attributable to the CFC2 stock have an aggregate basis of $13.13x ($30x multiplied by $56x/$128x) and fair market value of $80x ($200x multiplied by $160x/$400x), resulting in aggregate gain in such portions of $66.88x (or $2.23x in each such portion of the 30 shares). The portions attributable to Asset A have an aggregate basis of $11.25x ($30x multiplied by $48x/$128x) and fair market value of $100x ($200x multiplied by $200x/$400x), resulting in aggregate gain in such portions of $88.75x (or $2.96x in each such portion of the 30 shares). Thus, the aggregate gain in all the portions of the 30 shares is $170x ($14.38x plus $66.88x plus $88.75x).

(*2*) With respect to US2's 18 shares of FA stock, the portions attributable to the CFC1 stock have an aggregate basis of $3.38x ($18x multiplied by $24x/$128x) and fair market value of $12x ($120x multiplied by $40x/$400x), resulting in aggregate gain in such portions of $8.63x (or $.48x in each such portion of the 18 shares). The portions attributable to the CFC2 stock have an aggregate basis of $7.88x ($18x multiplied by $56x/$128x) and fair market value of $48x ($120x multiplied by $160x/$400x), resulting in aggregate gain of $40.13x (or $2.23x in each such portion of the 18 shares). The portions attributable to Asset A have an aggregate basis of $6.75x ($18x multiplied by $48x/$128x) and fair market value of $60x ($120x multiplied by $200x/$400x), resulting in aggregate gain of $53.25x (or $2.96x in each such portion of the 18 shares). Thus, the aggregate gain in all the portions of the 18 shares is $102x ($8.63x plus $40.13x plus $53.25x).

(*3*) Under §1.1248–8(b)(2)(iv), the earnings and profits of CFC1 attributable to the portions of US1's 30 shares of FA stock that relate to the CFC1 stock is $15x (the product of US1's 50% ownership interest percentage in UST multiplied by $30x of earnings and profits attributable to the CFC1 stock before the section 361 exchange, reduced by $0x of dividend included in UST's income with respect to the CFC1 stock under section 1248(a) attributable to US1). The earnings and profits of CFC2 attributable to the portions of US1's 30 shares of FA stock that relate to the CFC2 stock is $75x (the product of US1's 50% ownership interest percentage in UST multiplied by $150x of earnings and profits attributable to the CFC2 stock before the section 361 exchange, reduced by $0x of dividend included in UST's income with respect to the CFC2 stock under section 1248(a) attributable to US1). Similarly, the earnings and profits of CFC1 attributable to the portions of US2's 18 shares of FA stock that relate to the CFC1 stock is $9x (the product of US2's 30% ownership interest percentage in UST multiplied by $30x of earnings and profits attributable to the CFC1 stock before the section 361 exchange, reduced by $0x of dividend included in UST's income with respect to the CFC1 stock under section 1248(a) attributable to US2). Finally, the earnings and profits of CFC2 attributable to the portions of US2's 18 shares of FA stock that relate to the CFC2 stock is $45x (the product of US2's 30% ownership interest percentage in UST multiplied by $150x of earnings and profits attributable to the CFC2 stock before the section 361 exchange, reduced by $0x of dividend included in UST's income with respect to the CFC2 stock under section 1248(a) attributable to US2).

(I) Under §1.1248(f)–2(c)(3), neither US1 nor US2 is required to reduce the aggregate section 358 basis in the portions of their respective shares of FA stock, and UST is not required to include in gross income any additional deemed dividend.

(*1*) US1 is not required to reduce the aggregate section 358 basis of the portions of its 30 shares of FA stock that relate to the CFC1 stock because the $10x section 1248(f) amount with respect to the CFC1 stock attributable to the portions of the shares of FA stock received by US1 (as computed in paragraph (ii)(G) of this *Example 3*) does not exceed US1's postdistribution amount (as defined in §1.1248(f)–1(c)(6), or $14.38x) in those portions. The $14.38x postdistribution amount equals the amount that US1 would be required to include in income as a dividend under section 1248(a) with respect to such portion if it sold the 30 shares of FA stock immediately after the distribution in a transaction in which all realized gain is recognized, without taking into account basis adjustments or income inclusions under §1.1248(f)–2(c)(3) ($20x fair market value, $5.63x basis, and $15x earnings and profits attributable to the portions for purposes of section 1248). Similarly, US1 is not required to reduce the aggregate section 358 basis of the portions of its 30 shares of FA stock that relate to the CFC2 stock because the $65x section 1248(f) amount with respect to the CFC2 stock attributable to the portions of the shares of FA stock received by US1 (as computed in paragraph (ii)(G) of this *Example 3*) does not exceed US1's postdistribution amount ($66.88x) in those portions. The $66.88x postdistribution amount equals the amount that US1 would be required to include in income as a dividend under section 1248(a) with respect to such portion if it sold the 30 shares of FA stock immediately after the distribution in a transaction in which all realized gain is recognized, without taking into account basis adjustments or income inclusions under §1.1248(f)–2(c)(3) ($80x fair market value, $13.13x basis, and $75x earnings and profits attributable to the portions for purposes of section 1248).

(*2*) US2 is not required to reduce the aggregate section 358 basis of the portions of its 18 shares of FA stock that relate to the CFC1 stock because the $6x section 1248(f) amount with respect to the CFC1 stock attributable to the portions of the shares of FA stock received by US2 (as computed in paragraph (ii)(G) of this *Example 3*) does not exceed US2's postdistribution amount ($8.63x) in those portions. The $8.63x postdistribution amount equals the amount that US2 would be required to include in income as a dividend under section 1248(a) with respect to such portion if it sold the 18 shares of FA stock immediately after the distribution in a transaction in which all realized gain is recognized, without taking into account basis adjustments or income inclusions under §1.1248(f)–2(c)(3) ($12x fair market value, $3.38x basis, and $9x earnings and profits attributable to the portions for purposes of section 1248). Similarly, US2 is not required to reduce the aggregate section 358 basis of the portions of its 18 shares of FA stock that relate to the CFC2 stock because the $39x section 1248(f) amount with respect to the CFC2 stock attributable to the portions of the shares of FA stock received by US2 (as computed in paragraph (ii)(G) of this *Example 3*) does not exceed US1's postdistribution amount ($40.13x) in those portions. The $40.13x postdistribution amount equals the amount that US2 would be required to include in income as a dividend under section 1248(a) with respect to such portion if it sold the 18 shares of FA stock immediately after the distribution in a transaction in which all realized gain is recognized, without taking into account basis adjustments or income inclusions under §1.1248(f)–2(c)(3) ($48x fair market value, $7.88x basis, and $45x earnings and profits attributable to the portions for purposes of section 1248).

(J) The amount of gain subject to the gain recognition agreement filed by each of US1 and US2 is determined pursuant to paragraph (e)(6)(i) of this section. The amount of gain subject to the gain recognition agreement filed by US1 with respect to the stock of CFC1 and CFC2 is $10x and $65x, respectively. The $10x and $65x are computed as the product of US1's ownership interest percentage (50%) multiplied by the gain realized by UST in the CFC1 stock ($20x) and CFC2 stock ($130x), respectively, as determined prior to taking into account the application of any other provision of section 367, reduced by the sum of the amounts described in paragraphs (e)(6)(i)(A), (e)(6)(i)(B), (e)(6)(i)(C), and (e)(6)(i)(D) of this section with respect to the CFC1 stock and CFC2 stock attributable to US1 ($0x with respect to the CFC1 stock, and $0x with respect to the CFC2 stock). The amount of gain subject to the gain recognition agreement filed by US2 with respect to the stock of CFC1 and CFC2 is $6x and $39x, respectively. The $6x and $39x are computed as the product of US2's ownership interest percentage (30%) multiplied by the gain realized by UST in the CFC1 stock ($20x) and CFC2 stock ($130x), respectively, as determined prior to taking into account the application of any other provision of section 367, reduced by the sum of the amounts described in paragraphs (e)(6)(i)(A), (e)(6)(i)(B), (e)(6)(i)(C), and (e)(6)(i)(D) of this section with respect to the CFC1 stock and CFC2 stock attributable to US2 ($0x with respect to the CFC1 stock, and $0x with respect to the CFC2 stock). X is not required to enter into a gain recognition agreement because the amount of gain that would be subject to the gain recognition agreement is $0x with respect to the CFC1 stock, and $0x with respect to the CFC2 stock, computed as X's ownership percentage (20%) multiplied by the gain realized in the stock of CFC1 ($20x multiplied by 20%, or $4x) and CFC2 ($130x multiplied by 20%, or $26x), reduced by the amount of gain recognized by UST with respect to the stock of CFC1 and CFC2 that is attributable to X pursuant to §1.367(a)–7(c)(2) ($4x and $26x, respectively, as determined in paragraph (ii)(C) of this *Example 3*). Pursuant to paragraph (e)(6)(ii) of this section, each gain recognition agreement must include the election described in §1.367(a)–8(c)(2)(vi). Furthermore, pursuant to paragraph (e)(6)(iii) of this section, US1 and US2 must be designated as the U.S. transferor on their respective gain recognition agreements for purposes of §1.367(a)–8.

(9) *Illustration of rules*. For rules relating to certain distributions of stock of a foreign corporation by a domestic corporation, see section 1248(f) and §§1.1248(f)–1 through 1.1248(f)–3.

(f) through (g)(1)(vi) [Reserved]. For further guidance, see §§1.367(a)–3(f) through (g)(1)(vi).

(vii)(A) Except as provided in this paragraph (g)(1)(vii), the rules of paragraph (e) of this section apply to transfers of stock or securities occurring on or after April 17, 2013. For matters covered in this section for periods before April 17, 2013, but on or after March 13, 2009, see §1.367(a)–3(e) as contained in 26 CFR part 1 revised as of April 1, 2012. For matters covered in this section for periods before March 13, 2009, but on or after March 7, 2007, see §1.367(a)–3T(e) as contained in 26 CFR part 1 revised as of April 1, 2007. For matters covered in this section for periods before March 7, 2007, but on or after July 20, 1998, see §1.367(a)–8(f)(2)(i) as contained in 26 CFR part 1 revised as of April 1, 2006.

(g)(1)(vii)(B) through (g)(1)(viii) [Reserved]. For further guidance see §1.367(a)–3(g)(vii)(B) through (g)(viii).

(ix) Paragraphs (d)(2)(vi)(B) and (d)(3), *Example 6B*, *Example 6C*, and *Example 9* of this section apply to transfers that occur on or after March 18, 2013. See paragraphs (d)(2)(vi)(B) and (d)(3), *Example 6B*, *Example 6C*, and *Example 9* of this section, as contained in 26 CFR part 1 revised as of April 1, 2012, for transfers that occur on or after January 23, 2006, and before March 18, 2013.

(g)(2) through (j) [Reserved]. For further guidance, see §1.367(a)–3(g)(2) through (j).

(k) *Expiration date*. Paragraphs (d)(2)(vi)(B), (d)(3), *Example 6B*, *Example 6C*, and *Example 9*, and paragraph (e) of this section expire on March 18, 2016.

Par. 4. Section 1.367(a)–6T is amended by:

1. Adding a sentence at the end of the paragraph (e)(4).
2. Adding paragraph (j).

The additions to read as follows:

§1.367(a)–6T Transfer of foreign branch with previously deducted losses (temporary).

* * * * *

(e) * * *

(4) * * * For transactions occurring on or after April 17, 2013**,** notwithstanding the prior sentence, this paragraph (e)(4) shall apply before the rules of §1.367(a)–7(c).

* * * * *

(j) *Expiration date*. The second sentence of paragraph (e)(4) of this section expires on March 18, 2016.

Par. 5. Section 1.367(a)–7T is added to read as follows:

§1.367(a)–7T Outbound transfers of property described in section 361(a) or (b).

(a) through (e)(1) [Reserved].For further guidance, see §1.367(a)–7(a) through (e)(1).

(2) *Reasonable cause for failure to comply (temporary)*—(i) *Request for relief*. A control group member's failure to timely comply with any requirement of this section shall be deemed not to have occurred if the control group member is able to demonstrate that the failure was due to reasonable cause and not willful neglect using the procedure set forth in paragraph (e)(2)(ii) of this section. Whether the failure to timely comply was due to reasonable cause and not willful neglect will be determined by the Director of Field Operations International, Large Business & International (or any successor to the roles and responsibilities of such person) (Director) based on all the facts and circumstances.

(ii) *Procedures for establishing that a failure to timely comply was due to reasonable cause and not willful neglect*—(A) *Time of submission*. A control group member's statement that the failure to timely comply was due to reasonable cause and not willful neglect will be considered only if, promptly after the control group member becomes aware of the failure, an amended return is filed for the taxable year to which the failure relates that includes the information that should have been included with the original return for such taxable year or that otherwise complies with the rules of this section, and that includes a written statement explaining the reasons for the failure to timely comply.

(B) *Notice requirement*. In addition to the requirements of paragraph (e)(2)(ii)(A) of this section, a control group member must comply with the notice requirements of this paragraph (e)(2)(ii)(B). If any taxable year of the control group member is under examination when the amended return is filed, a copy of the amended return and any information required to be included with such return must be delivered to the Internal Revenue Service personnel conducting the examination. If no taxable year of the control group member is under examination when the amended return is filed, a copy of the amended return and any information required to be included with such return must be delivered to the Director.

(iii) *Cross-reference for reasonable cause relief requests by U.S. transferor*. If the U.S. transferor fails to timely comply with any requirement of this section, the U.S. transferor will be treated as having timely complied with the requirement if the U.S. transferor (or the foreign acquiring corporation on behalf of the U.S. transferor) satisfies the reasonable cause requirements described in §1.6038B–1T(f)(3).

(iv) *Effective/applicability date.* The rules of paragraphs (e)(2)(i) through (e)(2)(iii) of this section shall apply to transactions occurring on or after April 17, 2013.

(v) *Expiration date*. Paragraphs (e)(2)(i) through (e)(2)(iv) of this section expire on March 18, 2016.

(e)(3) through (j) [Reserved]. For further guidance, see §1.367(a)–7(e)(3) through (j).

Par. 6. Section 1.1248(f)–3T is added to read as follows:

§1.1248(f)–3T Reasonable cause and effective/applicability dates (temporary).

(a) *Reasonable cause for failure to comply*—(1) *Request for relief.* If an 80-percent distributee, a distributee that is a section 1248 shareholder, or the domestic distributing corporation (reporting person) fails to timely comply with any requirement under §1.1248(f)–2, the failure shall be deemed not to have occurred if the reporting person is able to demonstrate that the failure was due to reasonable cause and not willful neglect using the procedure set forth in paragraph (a)(2) of this section. Whether the failure to timely comply was due to reasonable cause and not willful neglect will be determined by the Director of Field Operations International, Large Business & International (or any successor to the roles and responsibilities of such person) (Director) based on all the facts and circumstances.

(2) *Procedures for establishing that a failure to timely comply was due to reasonable cause and not willful neglect*—(i) *Time of submission*. A reporting person's statement that the failure to timely comply was due to reasonable cause and not willful neglect will be considered only if, promptly after the reporting person becomes aware of the failure, an amended return is filed for the taxable year to which the failure relates that includes the information that should have been included with the original return for such taxable year or that otherwise complies with the rules of this section, and that includes a written statement explaining the reasons for the failure to timely comply.

(ii) *Notice requirement*. In addition to the requirements of paragraph (a)(2)(i) of this section, the reporting person must comply with the notice requirements of this paragraph (a)(2)(ii). If any taxable year of the reporting person is under examination when the amended return is filed, a copy of the amended return and any information required to be included with such return must be delivered to the Internal Revenue Service personnel conducting the examination. If no taxable year of the reporting person is under examination when the amended return is filed, a copy of the amended return and any information required to be included with such return must be delivered to the Director.

(3) *Effective/applicability date*. This section applies to distributions occurring on or after April 17, 2013.

(4) *Expiration date*. Paragraphs (a)(1) through (a)(3) of this section expire on March 18, 2016.

Par. 7. Section 1.6038B–1T is amended by revising paragraph (f) to read:

§1.6038B–1T Reporting of certain transfers to foreign corporations.

* * * * *

(f)(1) through (f)(2) [Reserved]. For further guidance, see §1.6038B–1(f)(1) through (f)(2).

(3) *Reasonable cause for failure to comply*—(i) *Request for relief*. If the U.S. transferor fails to comply with any requirement of section 6038B and this section, the failure shall be deemed not to have occurred if the U.S. transferor is able to demonstrate that the failure was due to reasonable cause and not willful neglect using the procedure set forth in paragraph (f)(3)(ii) of this section. Whether the failure to timely comply was due to reasonable cause and not willful neglect will be determined by the Director of Field Operations International, Large Business & International (or any successor to the roles and responsibilities of such person) (Director) based on all the facts and circumstances.

(ii) *Procedures for establishing that a failure to timely comply was due to reasonable cause and not willful neglect*—(A) *Time of submission*. A U.S. transferor's statement that the failure to timely comply was due to reasonable cause and not willful neglect will be considered only if, promptly after the U.S. transferor becomes aware of the failure, an amended return is filed for the taxable year to which the failure relates that includes the information that should have been included with the original return for such taxable year or that otherwise complies with the rules of this section, and that includes a written statement explaining the reasons for the failure to timely comply.

(B) *Notice requirement*. In addition to the requirements of paragraph (f)(3)(ii)(A) of this section, the U.S. transferor must comply with the notice requirements of this paragraph (f)(3)(ii)(B). If any taxable year of the U.S. transferor is under examination when the amended return is filed, a copy of the amended return and any information required to be included with such return must be delivered to the Internal Revenue Service personnel conducting the examination. If no taxable year of the U.S. transferor is under examination when the amended return is filed, a copy of the amended return and any information required to be included with such return must be delivered to the Director.

(iii) *Effective/applicability date*. This section applies to distributions occurring on or after April 17, 2013.

(iv) *Expiration date*. Paragraphs (f)(3)(i) through (f)(3)(iii) of this section expire on March 18, 2016.

(f)(4) [Reserved]. For further guidance, see §1.6038B–1T(f)(4).

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

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

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

Par.9. In §602.101, the table in paragraph (b) is amended by adding the following entry numerical order:

§602.101 OMB Control numbers.

* * * * *

(b) * * *

CFR part or section where Identified and described		Current OMB control No.
* * * * * * *		
1.367(a)–3T	....	1545–2183
* * * * * * *		
1.367(a)–7T	....	1545–2183
* * * * * * *		
1.1248(f)–3T	....	1545–2183
* * * * * * *		
1.6038B–1T	....	1545–2183
* * * * * * *		

* * * * *

Steven T. Miller,
Deputy Commissioner for Services and Enforcement.

Approved February 19, 2013.

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

(Filed by the Office of the Federal Register on March 18, 2013, 8:45 a.m., and published in the issue of the Federal Register for March 19, 2013, 78 F.R. 17053)

Update for Weighted Average Interest Rates, Yield Curves, and Segment Rates

Notice 2013–28

This notice provides guidance on the corporate bond monthly yield curve (and the corresponding spot segment rates), and the 24-month average segment rates under § 430(h)(2) of the Internal Revenue Code. In addition, this notice provides guidance as to the interest rate on 30-year Treasury securities under § 417(e)(3)(A)(ii)(II) as in effect for plan years beginning before 2008, the 30-year Treasury weighted average rate under § 431(c)(6)(E)(ii)(I), and the minimum present value segment rates under § 417(e)(3)(D) as in effect for plan years beginning after 2007. These rates reflect certain changes implemented by the Moving Ahead for Progress in the 21st Century Act, Public Law 112–141 (MAP–21). MAP–21 provides that for purposes of § 430(h)(2), the segment rates are limited by the applicable maximum percentage or the applicable minimum percentage based on the average of segment rates over a 25 year period.

YIELD CURVE AND SEGMENT RATES

Generally, except for certain plans under sections 104 and 105 of the Pension Protection Act of 2006, § 430 of the Code specifies the minimum funding requirements that apply to single employer plans pursuant to § 412. Section 430(h)(2) specifies the interest rates that must be used to determine a plan's target normal cost and funding target. Under this provision, present value is generally determined using three 24-month average interest rates ("segment rates"), each of which applies to cash flows during specified periods. To the extent provided under § 430(h)(2)(C)(iv), these segment rates are adjusted by the applicable percentage of the 25-year average segment rates for the period ending September 30 of the year preceding the calendar year in which the plan year begins. However, an election may be made under § 430(h)(2)(D)(ii) to use the monthly yield curve in place of the segment rates.

Notice 2007–81, 2007–44 I.R.B. 899, provides guidelines for determining the monthly corporate bond yield curve, and the 24-month average corporate bond segment rates used to compute the target normal cost and the funding target. Pursuant to Notice 2007–81, the monthly corporate bond yield curve derived from March 2013 data is in Table I at the end of this notice. The spot first, second, and third segment rates for the month of March 2013 are, respectively, 0.97, 3.82, and 5.11. For plan years beginning on or after January 1, 2012, the 24-month average segment rates determined under § 430(h)(2)(C)(iv) must be adjusted by the applicable percentage of the corresponding 25-year average segment rates. The 25-year average segment rates for plan years beginning in 2012 and for plan years beginning in 2013 were published in Notices 2012–55 and 2013–11, respectively. The three 24-month average corporate bond segment rates applicable for April 2013 without adjustment, and the adjusted 24-month average segment rates taking into account the applicable percentages of the corresponding 25-year average segment rates, are as follows:

For Plan Years Beginning In	Applicable Month		24-Month Average Segment Rates Not Adjusted			Adjusted 24-Month Average Segment Rates, Based on Applicable Percentage of 25-Year Average Rates		
			First Segment	Second Segment	Third Segment	First Segment	Second Segment	Third Segment
2012	April	2013	1.50	4.22	5.26	5.54	6.85	7.52
2013	April	2013	1.50	4.22	5.26	4.94	6.15	6.76

30-YEAR TREASURY SECURITIES INTEREST RATES

Generally for plan years beginning after 2007, § 431 specifies the minimum funding requirements that apply to multiemployer plans pursuant to § 412. Section 431(c)(6)(B) specifies a minimum amount for the full-funding limitation described in section 431(c)(6)(A), based on the plan's current liability. Section 431(c)(6)(E)(ii)(I) provides that the interest rate used to calculate current liability for this purpose must be no more than 5 percent above and no more than 10 percent below the weighted average of the rates of interest on 30-year Treasury securities during the four-year period ending on the last day before the beginning of the plan year. Notice 88–73, 1988–2 C.B. 383, provides guidelines for determining the weighted average interest rate. The rate of interest on 30-year Treasury securities for March 2013 is 3.16 percent. The Service has determined this rate as the average of the daily determinations of yield on the 30-year Treasury bond maturing in February 2043. The following rates were determined for plan years beginning in the month shown below.

For Plan Years Beginning in		30-Year Treasury Weighted	Permissible Range	
Month	*Year*	Average	90%	to 105%
April	2013	3.52	3.17	3.69

MINIMUM PRESENT VALUE SEGMENT RATES

In general, the applicable interest rates under § 417(e)(3)(D) are segment rates computed without regard to a 24-month average. Notice 2007–81 provides guidelines for determining the minimum present value segment rates. Pursuant to that notice, the minimum present value transitional segment rates determined for March 2013 are as follows:

First Segment	Second Segment	Third Segment
0.97	3.82	5.11

DRAFTING INFORMATION

The principal author of this notice is Tony Montanaro of the Employee Plans, Tax Exempt and Government Entities Division. Mr. Montanaro may be e-mailed at *RetirementPlanQuestions@irs.gov*.

Table I

Monthly Yield Curve for March 2013
Derived from March 2013 Data

Maturity	*Yield*	*Maturity*	*Yield*	*Maturity*	*Yield*	*Maturity*	*Yield*	*Maturity*	*Yield*
0.5	0.31	20.5	4.78	40.5	5.15	60.5	5.29	80.5	5.36
1.0	0.47	21.0	4.79	41.0	5.16	61.0	5.29	81.0	5.36
1.5	0.63	21.5	4.81	41.5	5.16	61.5	5.30	81.5	5.36
2.0	0.77	22.0	4.83	42.0	5.17	62.0	5.30	82.0	5.36
2.5	0.90	22.5	4.84	42.5	5.17	62.5	5.30	82.5	5.37
3.0	1.03	23.0	4.85	43.0	5.18	63.0	5.30	83.0	5.37
3.5	1.16	23.5	4.87	43.5	5.18	63.5	5.30	83.5	5.37
4.0	1.31	24.0	4.88	44.0	5.19	64.0	5.31	84.0	5.37
4.5	1.47	24.5	4.89	44.5	5.19	64.5	5.31	84.5	5.37
5.0	1.64	25.0	4.90	45.0	5.20	65.0	5.31	85.0	5.37
5.5	1.83	25.5	4.91	45.5	5.20	65.5	5.31	85.5	5.37
6.0	2.02	26.0	4.93	46.0	5.20	66.0	5.31	86.0	5.37
6.5	2.22	26.5	4.94	46.5	5.21	66.5	5.32	86.5	5.38
7.0	2.43	27.0	4.95	47.0	5.21	67.0	5.32	87.0	5.38
7.5	2.62	27.5	4.96	47.5	5.22	67.5	5.32	87.5	5.38
8.0	2.82	28.0	4.97	48.0	5.22	68.0	5.32	88.0	5.38
8.5	3.00	28.5	4.98	48.5	5.22	68.5	5.32	88.5	5.38
9.0	3.18	29.0	4.99	49.0	5.23	69.0	5.33	89.0	5.38
9.5	3.35	29.5	5.00	49.5	5.23	69.5	5.33	89.5	5.38
10.0	3.50	30.0	5.01	50.0	5.23	70.0	5.33	90.0	5.38
10.5	3.64	30.5	5.02	50.5	5.24	70.5	5.33	90.5	5.38
11.0	3.77	31.0	5.03	51.0	5.24	71.0	5.33	91.0	5.39
11.5	3.89	31.5	5.04	51.5	5.24	71.5	5.33	91.5	5.39
12.0	4.00	32.0	5.04	52.0	5.25	72.0	5.34	92.0	5.39
12.5	4.10	32.5	5.05	52.5	5.25	72.5	5.34	92.5	5.39
13.0	4.19	33.0	5.06	53.0	5.25	73.0	5.34	93.0	5.39
13.5	4.26	33.5	5.07	53.5	5.26	73.5	5.34	93.5	5.39
14.0	4.33	34.0	5.07	54.0	5.26	74.0	5.34	94.0	5.39
14.5	4.39	34.5	5.08	54.5	5.26	74.5	5.34	94.5	5.39
15.0	4.45	35.0	5.09	55.0	5.26	75.0	5.35	95.0	5.39
15.5	4.50	35.5	5.10	55.5	5.27	75.5	5.35	95.5	5.39
16.0	4.54	36.0	5.10	56.0	5.27	76.0	5.35	96.0	5.39
16.5	4.58	36.5	5.11	56.5	5.27	76.5	5.35	96.5	5.40
17.0	4.61	37.0	5.11	57.0	5.27	77.0	5.35	97.0	5.40
17.5	4.64	37.5	5.12	57.5	5.28	77.5	5.35	97.5	5.40
18.0	4.67	38.0	5.13	58.0	5.28	78.0	5.35	98.0	5.40
18.5	4.70	38.5	5.13	58.5	5.28	78.5	5.36	98.5	5.40
19.0	4.72	39.0	5.14	59.0	5.28	79.0	5.36	99.0	5.40
19.5	4.74	39.5	5.14	59.5	5.29	79.5	5.36	99.5	5.40
20.0	4.76	40.0	5.15	60.0	5.29	80.0	5.36	100.0	5.40

Part IV. Items of General Interest

Notice of Proposed Rulemaking

Indirect Stock Transfers and Coordination Rule Exceptions; Transfers of Stock or Securities in Outbound Asset Reorganizations

REG–132702–10

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: In this issue of the Bulletin, the IRS and the Treasury Department are issuing temporary regulations that eliminate one of two exceptions to the coordination rule between asset transfers and indirect stock transfers for certain outbound asset reorganizations. The temporary regulations also modify the exception to the coordination rule for certain outbound exchanges so that it is consistent with the remaining asset reorganization exception. In addition, the regulations modify, in various contexts, procedures for obtaining reasonable cause relief. Finally, the temporary regulations implement certain changes with respect to transfers of stock or securities by a domestic corporation to a foreign corporation in a section 361 exchange. The regulations primarily affect domestic corporations that transfer property to foreign corporations in certain outbound nonrecognition exchanges. The text of the temporary regulations published in this issue of the Bulletin also serves as the text of these proposed regulations.

DATES: Comments and requests for a public hearing must be received by June 17, 2013.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–132702–10), room 5205, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–132702–10), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW, Washington, DC, or sent electronically via the Federal eRulemaking Portal at *http://www.regulations.gov* (IRS REG–132702–10).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Robert B. Williams, Jr., (202) 622–3860; concerning submissions of comments or requests for a public hearing, Oluwafunmilayo Taylor, (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background and Explanation of Provisions

Temporary regulations in the Rules and Regulations section of this issue of the **Federal Register** amend the Income Tax Regulations (26 CFR part 1) under section 367 of the Internal Revenue Code (Code). The text of those regulations also serves as the text of these proposed regulations. The preamble to the temporary regulations explains the amendments.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It is hereby certified that the collections of information contained in these regulations will not have a significant economic impact on a substantial number of small entities. Accordingly, a regulatory flexibility analysis is not required. These regulations primarily will affect United States persons that are large corporations engaged in corporate transactions among their controlled corporations. Thus, the number of affected small entities—in whichever of the three categories defined in the Regulatory Flexibility Act (small businesses, small organizations, and small governmental jurisdictions)—will not be substantial. The IRS and the Treasury Department estimate that small organizations and small governmental jurisdictions are likely to be affected only insofar as they transfer the stock of a controlled corporation to a related corporation. While a certain number of small entities may engage in such transactions, the IRS and the Treasury Department do not anticipate the number to be substantial. Pursuant to section 7805(f) of the Code, this regulation has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any comments that are submitted timely to the IRS as prescribed in this preamble under "Addresses" heading. The IRS and the Treasury Department request comments on all aspects of the proposed rules. All comments will be available at *www.regulations.gov* or upon request. A public hearing will be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the **Federal Register**.

Drafting Information

The principal author of these regulations is Robert B. Williams, Jr. of the Office of Associate Chief Counsel (International). However, other personnel from the IRS and the Treasury Department participated in their development.

* * * * *

Proposed Amendments to the Regulations

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

PART 1—INCOME TAXES

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

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

Par. 2. Section 1.367(a)–3 is amended by:

1. Revising paragraphs (d)(2)(vi)(B), (d)(3) *Example 6B*, *Example 6C*, and *Example 9*.

2. Revising paragraph (e).

3. Adding paragraphs (g)(1)(vii)(A) and (g)(1)(ix) .

The revisions and additions to read as follows:

§1.367(a)–3 Treatment of transfers of stock or securities to foreign corporations.

* * * * *

(d) * * *

(2) * * *

(vi) * * *

(B) [The text of proposed §1.367(a)–3(d)(2)(vi)(B) is the same as the text of §1.367(a)–3T(d)(2)(vi)(B) published elsewhere in this issue of the Bulletin.

* * * * *

(3) * * *

Example 6B. [The text of proposed §1.367(a)–3(d)(3) *Example 6B* is the same as the text of §1.367(a)–3T(d)(3) *Example 6B* published elsewhere in this issue of the Bulletin.

Example 6C. [The text of proposed §1.367(a)–3(d)(3) *Example 6C* is the same as the text of §1.367(a)–3T(d)(3) *Example 6C* published elsewhere in this issue of the Bulletin.

* * * * *

Example 9. [The text of proposed §1.367(a)–3(d)(3) *Example 9* is the same as the text of §1.367(a)–3T(d)(3) *Example 9* published elsewhere in this issue of the Bulletin.

* * * * *

(e) [The text of proposed §1.367(a)–3(e) is the same as the text of §1.367(a)–3T(e) published elsewhere in this issue of the Bulletin.

* * * * *

(g)* * *(1)* * *

(vii)(A) [The text of proposed §1.367(a)–3(a)(1)(vii)(A) is the same as the text of §1.367(a)–3T(g)(1)(vii)(A) published elsewhere in this issue of the Bulletin.

* * * * *

(ix) [The text of proposed §1.367(a)–3(g)(1)(ix) is the same as the text of §1.367(a)–3T(g)(1)(ix) published elsewhere in this issue of the Bulletin.

* * * * *

Par. 3. Section 1.367(a)–6 is amended by revising paragraph (e)(4) to read as follows:

§1.367(a)–6 Transfer of foreign branch with previously deducted losses.

* * * * *

(e) * * *

(4) * * * [The text of the final sentence of proposed §1.367(a)–6(e)(4) is the same as the text of the final sentence of §1.367(a)–6T(e)(4) published elsewhere in this issue of the Bulletin.

Par. 4. Section 1.367(a)–7 is amended by revising paragraph (e)(2) to read as follows:

§1.367(a)–7 Outbound transfers of property described in section 361(a) or (b).

* * * * *

(e) * * *

(2) [The text of proposed §1.367(a)–7(e)(2) is the same as the text of §1.367(a)–7T(e)(2) published elsewhere in this issue of the Bulletin.

* * * * *

Par. 5. Section 1.1248(f)–3 is amended by revising paragraph (a) to read as follows:

§1.1248(f)–3 Reasonable cause and effective/applicability dates.

(a) [The text of proposed §1.1248(f)–3 is the same as the text of proposed §1.1248(f)–3T published elsewhere in this issue of the Bulletin.

* * * * *

Par. 6. Section 1.6038B–1 is amended by revising paragraph (f)(3) to read as follows:

§1.6038B–1 Reporting of certain transfers to foreign corporations.

* * * * *

(f) * * *

(3) [The text of proposed §1.6038B–1(f)(3) is the same as the text of §1.6038B–1T(f)(3) published elsewhere in this issue of the Bulletin.

* * * * *

Steven T. Miller,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on March 18, 2013, 8:45 a.m., and published in the issue of the Federal Register for March 19, 2013, 78 FR 17066)

Notice of Proposed Rulemaking

Ninety-Day Waiting Period Limitation and Technical Amendments to Certain Health Coverage Requirements Under the Affordable Care Act

REG–122706–12

AGENCIES: Internal Revenue Service, Department of the Treasury; Employee Benefits Security Administration, Department of Labor; Centers for Medicare & Medicaid Services, Department of Health and Human Services.

ACTION: Proposed rules.

SUMMARY: These proposed rules implement the 90-day waiting period limitation under section 2708 of the Public Health Service Act, as added by the Patient Protection and Affordable Care Act (Affordable Care Act), as amended, and incorporated into the Employee Retirement Income Security Act of 1974 and the Internal Revenue Code. They also propose amendments to regulations to conform to Affordable Care Act provisions already in effect as well as those that will become effective beginning 2014. The proposed conforming amendments make changes to existing requirements such as preexisting condition limitations and other portability provisions added by the Health Insurance Portability and Accountability Act of 1996 (HIPAA) and implementing regulations because they have become moot or need amendment due to new market reform protections under the Affordable Care Act.

DATES: Comments are due on or before May 20, 2013.

ADDRESSES: Written comments may be submitted to the Department of Labor as specified below. Any comment that is submitted will be shared with the other Departments and will also be made available to the public. Warning: Do not include any personally identifiable information (such as name, address, or other contact information) or confidential business information that you do not want publicly disclosed. All comments may be posted on the Internet and can be retrieved by most Internet search engines. No deletions, modifications, or redactions will be made to the comments received, as they are public records. Comments may be submitted anonymously.

Comments, identified by "Waiting Periods", may be submitted by one of the following methods:

Federal eRulemaking Portal: http://www.regulations.gov. Follow the instructions for submitting comments.

Mail or Hand Delivery: Office of Health Plan Standards and Compliance Assistance, Employee Benefits Security Administration, Room N–5653, U.S. Department of Labor, 200 Constitution Avenue NW, Washington, DC 20210, *Attention*: Waiting Periods.

Comments received will be posted without change to *www.regulations.gov* and available for public inspection at the Public Disclosure Room, N–1513, Employee Benefits Security Administration, 200 Constitution Avenue, NW, Washington, DC 20210, including any personal information provided.

FOR FURTHER INFORMATION CONTACT: Amy Turner or Elizabeth Schumacher, Employee Benefits Security Administration, Department of Labor, at (202) 693–8335; Karen Levin or Kathryn Johnson, Internal Revenue Service, Department of the Treasury, at (202) 927–9639; or Cam Moultrie Clemmons, Centers for Medicare & Medicaid Services, Department of Health and Human Services, at (410) 786–1565.

Customer service information: Individuals interested in obtaining information from the Department of Labor concerning employment-based health coverage laws may call the EBSA Toll-Free Hotline at 1–866–444–EBSA (3272) or visit the Department of Labor's website (*www.dol.gov/ebsa*). In addition, information from HHS on private health insurance for consumers can be found on the Centers for Medicare & Medicaid Services (CMS) website (*www.cciio.cms.gov/*) and information on health reform can be found at *www.HealthCare.gov*.

SUPPLEMENTARY INFORMATION:

I. Background

The Patient Protection and Affordable Care Act, Pub. L. 111–148, was enacted on March 23, 2010, and the Health Care and Education Reconciliation Act, Pub. L. 111–152, was enacted on March 30, 2010. (They are collectively known as the "Affordable Care Act".) The Affordable Care Act reorganizes, amends, and adds to the provisions of part A of title XXVII of the Public Health Service Act (PHS Act) relating to group health plans and health insurance issuers in the group and individual markets. The term "group health plan" includes both insured and self-insured group health plans.[1] The Affordable Care Act adds section 715(a)(1) to the Employee Retirement Income Security Act (ERISA) and section 9815(a)(1) to the Internal Revenue Code (the Code) to incorporate the provisions of part A of title XXVII of the PHS Act into ERISA and the Code, and to make them applicable to group health plans and health insurance issuers providing health insurance coverage in connection with group health plans. The PHS Act sections incorporated by these references are sections 2701 through 2728.

PHS Act section 2708, as added by the Affordable Care Act and incorporated into ERISA and the Code, provides that a group health plan or health insurance issuer offering group health insurance coverage shall not apply any waiting period (as defined in PHS Act section 2704(b)(4)) that exceeds 90 days. PHS Act section 2704(b)(4), ERISA section 701(b)(4), and Code section 9801(b)(4) define a waiting period to be the period that must pass with respect to an individual before the individual is eligible to be covered for benefits under the terms of the plan. In 2004 regulations implementing the Health Insurance Portability and Accountability Act of 1996 (HIPAA) portability provisions (2004 HIPAA regulations), the Departments of Labor, Health and Human Services, and the Treasury (the Departments) defined a waiting period to mean the period that must pass before coverage for an employee or dependent who is otherwise eligible to enroll under the terms of a group health plan can become effective.[2] PHS Act section 2708 applies to both grandfathered and non-grandfathered group health plans and group health insurance coverage for plan years beginning on or after January 1, 2014.

PHS Act section 2708 does not require an employer to offer coverage to any particular employee or class of employees, including part-time employees. PHS Act section 2708 merely prevents an otherwise eligible employee (or dependent) from being required to wait more than 90 days before coverage becomes effective. Furthermore, nothing in the Affordable Care Act penalizes small employers for choosing not to offer coverage, or applicable large employers, as defined in the employer shared responsibility provisions under Code section 4980H, for choosing to limit their offer of coverage to full-time employees (and their dependents), as defined in the employer shared responsibility provisions under Code section 4980H.

On February 9, 2012, the Departments issued guidance[3] outlining various approaches under consideration with respect to both the 90-day waiting period limitation and the employer shared responsibility provisions under Code section 4980H (February 2012 guidance). Public comments were invited generally, as well as specifically, regarding how rules relating to the potential look-back/stability period safe harbor method for determining the number of full-time employees under Code section 4980H should be coordinated with the 90-day waiting period limitation.

On August 31, 2012, following their review of the comments on the February 2012 guidance, the Departments provided temporary guidance,[4] to remain in effect at least through the end of 2014, regard-

[1] The term "group health plan" is used in title XXVII of the PHS Act, part 7 of ERISA, and chapter 100 of the Code, and is distinct from the term "health plan," as used in other provisions of title I of the Affordable Care Act. The term "health plan" does not include self-insured group health plans.

[2] 26 CFR 54.9801–3(a)(3)(iii), 29 CFR 2590.701–3(a)(3)(iii), and 45 CFR 146.111(a)(3)(iii).

[3] Department of Labor Technical Release 2012–01, IRS Notice 2012–17, and HHS FAQs issued February 9, 2012.

[4] Department of Labor Technical Release 2012–02, IRS Notice 2012–59, and HHS FAQs issued August 31, 2012.

ing the 90-day waiting period limitation, and described the approach they intended to propose in rulemaking in the future (August 2012 guidance). The August 2012 guidance provides that employers, plans, and issuers may rely on the compliance guidance at least through the end of 2014 and that, for purposes of enforcement by the Departments, compliance with the approach set forth in the August 2012 guidance will be considered compliance with the provisions of PHS Act section 2708 at least through the end of 2014.

In general, the August 2012 guidance provides, among other things, that eligibility conditions based solely on the lapse of a time period are permissible for no more than 90 days. Other conditions for eligibility under the terms of a group health plan are generally permissible under PHS Act section 2708, unless the condition is designed to avoid compliance with the 90-day waiting period limitation. The August 2012 guidance further clarifies that if, under the terms of a plan, an employee may elect coverage that would begin on a date that does not exceed the 90-day waiting period limitation, the 90-day waiting period limitation is considered satisfied and, accordingly, a plan or issuer will not be considered to have violated PHS Act section 2708 solely because employees may take additional time to elect coverage.

The August 2012 guidance also addresses the application of PHS Act section 2708 to variable-hour employees in cases in which a specified number of hours of service per period is a plan eligibility condition. Specifically, the guidance provides that if a group health plan conditions eligibility on an employee regularly working a specified number of hours per period (or working full-time), and it cannot be determined that a newly-hired employee is reasonably expected to regularly work that number of hours per period (or work full-time), the plan may take a reasonable period of time to determine whether the employee meets the plan's eligibility condition, which may include a measurement period that is consistent with the timeframe permitted for such determinations under Code section 4980H.[5] Except in cases in which a waiting period that exceeds 90 days is imposed in addition to a measurement period, the time period for determining whether such an employee meets the plan's eligibility condition will not be considered to be designed to avoid compliance with the 90-day waiting period limitation if coverage is made effective no later than 13 months from the employee's start date, plus if the employee's start date is not the first day of a calendar month, the time remaining until the first day of the next calendar month.

The August 2012 guidance also addresses application of the rules to plans with cumulative hours-of-service requirements. The August 2012 guidance includes an example stating that, if a plan's cumulative hours-of-service requirement is more than 1,200 hours, the Departments would consider the requirement to be designed to avoid compliance with the 90-day waiting period limitation.

After consideration of all of the comments received in response to the February 2012 guidance and in response to the August 2012 guidance, the Departments are proposing these regulations. Public comments on these proposed regulations are invited.

II. Overview of the Proposed Regulations

A. *Prohibition on Waiting Periods That Exceed 90 Days*

These regulations propose that a group health plan, and a health insurance issuer offering group health insurance coverage, not apply any waiting period that exceeds 90 days. (Neither a plan nor an issuer offering coverage is required to have any waiting period.) If, under the terms of the plan, an employee can elect coverage that becomes effective on a date that does not exceed the 90-day waiting period limitation, the coverage complies with the waiting period rules, and the plan or issuer will not be considered to violate the waiting period rules merely because individuals choose to elect coverage beyond the end of the 90-day waiting period.

In these proposed regulations, the definition of waiting period is the same as that used in the 2004 HIPAA regulations. (However, the definition is proposed to be moved from the section on preexisting condition exclusions to this section. See below for an explanation of other technical and conforming changes proposed to be made to the 2004 HIPAA regulations.) Accordingly, under these proposed regulations, waiting period would continue to be defined as the period that must pass before coverage for an employee or dependent who is otherwise eligible to enroll under the terms of a group health plan can become effective. These proposed regulations would also continue to include the clarification that, if an employee or dependent enrolls as a late enrollee or special enrollee, any period before such late or special enrollment is not a waiting period. The effective date of coverage for special enrollees continues to be that set forth in the Departments' 2004 HIPAA regulations governing special enrollment.[6]

Paragraph (c) of the proposed regulations sets forth rules governing the relationship between a plan's eligibility criteria and the 90-day waiting period limitation. Specifically, this paragraph provides that being otherwise eligible to enroll in a plan means having met the plan's substantive eligibility conditions (such as being in an eligible job classification or achieving job-related licensure requirements specified in the plan's terms). However, the 90-day waiting period limitation generally does not require the plan sponsor to offer coverage to any particular employee or class of employees (including, for example, part-time employees). Instead, these proposed regulations would prohibit requiring otherwise eligible participants and beneficiaries to wait more than 90 days before coverage is effective.[7]

Under these proposed regulations, eligibility conditions that are based solely on the lapse of a time period would be permissible for no more than 90 days. Other conditions for eligibility under the terms

[5] The August 2012 guidance provides that an employer may use a measurement period that is consistent with Code section 4980H, whether or not it is an applicable large employer subject to Code section 4980H.

[6] 26 CFR 54.9801–6, 29 CFR 2590.701–6, and 45 CFR 146.117.

[7] While a substantive eligibility condition that denies coverage for employees may be permissible under PHS Act section 2708, an applicable large employer's denial of coverage to a full-time employee may, nonetheless, give rise to an assessable payment under section 4980H of the Code and its implementing regulations.

of a group health plan (*i.e.*, those that are not based solely on the lapse of a time period) are generally permissible under PHS Act section 2708 and these proposed regulations unless the condition is designed to avoid compliance with the 90-day waiting period limitation.

These regulations propose an approach when applying waiting periods to variable-hour employees in cases in which a specified number of hours of service per period (such as 30 hours per week or 250 hours per quarter) is a plan eligibility condition. Under these proposed regulations, if a group health plan conditions eligibility on an employee regularly having a specified number of hours of service per period (or working full-time), and it cannot be determined that a newly-hired employee is reasonably expected to regularly work that number of hours per period (or work full-time), the plan may take a reasonable period of time to determine whether the employee meets the plan's eligibility condition, which may include a measurement period of no more than 12 months that begins on any date between the employee's start date and the first day of the first calendar month following the employee's start date. (This is consistent with the timeframe permitted for such determinations under Code section 4980H and its implementing regulations.) Except for cases in which a waiting period that exceeds 90 days is imposed in addition to a measurement period, the time period for determining whether a variable-hour employee meets the plan's hours of service per period eligibility condition will not be considered to be designed to avoid compliance with the 90-day waiting period limitation if coverage is made effective no later than 13 months from the employee's start date, plus if the employee's start date is not the first day of a calendar month, the time remaining until the first day of the next calendar month.

Some commenters requested clarification regarding employees with specific or unique work schedules, and whether they would be treated as variable-hour employees. In this regard, unlike the rules under Code section 4980H, whether an employee has been appropriately classified as part-time, full-time, or variable-hour is of limited application under PHS Act section 2708. That is, conditions for eligibility under the terms of a group health plan are generally permissible under PHS Act section 2708, unless based solely on the lapse of time or designed to avoid compliance with the 90-day waiting period limitation. Accordingly, plan provisions that base eligibility on whether an employee is, for example, meeting certain sales goals or earning a certain level of commission, are generally substantive eligibility provisions that do not trigger the 90-day waiting period limitation. Some plan eligibility provisions, such as whether an employee has a specified number of hours of service per period (such as 30 hours per week or 250 hours per quarter) necessarily require the passage of time in order to determine whether the plan's substantive eligibility provision has been met. These proposed regulations set forth an approach under which such plan provisions will not be considered to be designed to avoid compliance with the 90-day waiting period limitation. However, whether a particular employee is classified appropriately as part-time, full-time, or variable-hour is generally not an issue under PHS Act section 2708, although other provisions of law (such as Code section 4980H, the HIPAA nondiscrimination provisions, and other provisions of ERISA) may be applicable.

Another type of plan eligibility provision addressed in the August 2012 guidance was cumulative hours-of-service requirements, which use more than solely the passage of a time period in determining whether employees are eligible for coverage. Specifically, the August 2012 guidance included an example stating that if a plan's cumulative hours-of-service requirement were more than 1,200 hours, the Departments would consider the requirement to be designed to avoid compliance with the 90-day waiting period limitation. Under these proposed regulations, if a group health plan or health insurance issuer conditions eligibility on any employee's (part-time or full-time) having completed a number of cumulative hours of service, the eligibility condition is not considered to be designed to avoid compliance with the 90-day waiting period limitation if the cumulative hours-of-service requirement does not exceed 1,200 hours.[8] Under the proposed rules, the plan's waiting period must begin once the new employee satisfies the plan's cumulative hours-of-service requirement and may not exceed 90 days. Furthermore, this provision is designed to be a one-time eligibility requirement only; these proposed regulations do not permit, for example, re-application of such a requirement to the same individual each year.

In response to the August 2012 guidance, some commenters requested clarification regarding application of the rule to plan provisions that require employees to work sufficient number of hours per measurement period but permit employees, if they do not have a sufficient number of hours, to make a self-payment (or buy-in) equal to the amount which would allow them to have a sufficient number of hours within the measurement period. PHS Act section 2708 and these proposed regulations do not prohibit plan procedures permitting self-payment (or buy-in) to satisfy any otherwise permissible hours-of-service requirement.

Some commenters raised concerns about communication between a plan and issuer regarding the 90-day limitation on waiting periods. Commenters stated that many issuers rely on the plan sponsor for information about an individual's eligibility for coverage and that issuers may not have knowledge of certain plan terms, such as eligibility conditions and waiting periods. These commenters expressed concern that health insurance issuers are required to comply with the requirements of PHS Act section 2708, but must rely on the information plan sponsors and employers report to them regarding eligibility information such as an employee's start date. At the same time, small employers purchasing insurance coverage often rely on their issuers for compliance assistance. Therefore, while the requirements of PHS Act section 2708 and these proposed regulations would be applicable to both the plan and issuer, to the extent coverage under a group health plan is insured by a health insurance issuer, paragraph (f) of the proposed regulations would provide that the issuer can rely on the eligibility

[8] While a cumulative hours-of-service eligibility condition up to 1,200 hours may be permissible under PHS Act section 2708, an applicable large employer's denial of coverage to a full-time employee may, nonetheless, give rise to an assessable payment under section 4980H of the Code and its implementing regulations.

information reported to it by an employer (or other plan sponsor) and will not be considered to violate the requirements of these proposed regulations in administering the 90-day waiting period limitation if the issuer requires the plan sponsor to make a representation regarding the terms of any eligibility conditions or waiting periods imposed by the plan sponsor before an individual is eligible to become covered under the terms of the employer's plan (and requires the plan sponsor to update this representation with any changes), and the issuer has no specific knowledge of the imposition of a waiting period that would exceed the permitted 90-day period.

Paragraph (d) of the proposed regulations clarifies the method for counting days when applying a 90-day waiting period. Some commenters stated that it is common practice to have a 90-day waiting period with coverage effective the first day of the month after the 90-day waiting period and requested flexibility for administrative ease. Others requested the Departments to create a *de minimis* exception for the difference between 90 days and 3 months. Under these proposed regulations, due to the clear text of the statute, the waiting period may not extend beyond 90 days and all calendar days are counted beginning on the enrollment date, including weekends and holidays. For a plan with a waiting period, "enrollment date" is defined as the first day of the waiting period.[9] If, with respect to a plan or issuer imposing a 90-day waiting period, the 91st day is a weekend or holiday, the plan or issuer may choose to permit coverage to be effective earlier than the 91st day, for administrative convenience. However, a plan or issuer may not make the effective date of coverage later than the 91st day.

The Departments recognize that multiemployer plans maintained pursuant to collective bargaining agreements have unique operating structures and may include different eligibility conditions based on the participating employer's industry or the employee's occupation. For example, some comments received on the August 2012 guidance gave examples of plan eligibility provisions based on complex formulas for earnings and residuals. As discussed earlier, the Departments view eligibility provisions that are based on compensation as substantive eligibility provisions that are not designed to avoid compliance with the 90-day waiting period limitation. In addition, hours banks, which are common multiemployer plan provisions that allow workers to bank excess hours from one measurement period and then draw down on them to compensate for any shortage in a succeeding measurement period and prevent lapses in coverage, function as buy-in provisions, which were discussed earlier as permissible. It is the Departments' view that the proposed rules provide flexibility to both multiemployer and single-employer health plans to meet their needs in defining eligibility criteria, while also ensuring that employees are protected from excessive waiting periods. Comments are invited on these proposed rules and on whether any additional examples or provisions are needed to address multiemployer plans.

These proposed regulations generally would apply for plan years beginning on or after January 1, 2014, consistent with the statutory effective date of PHS Act section 2708. The rules would apply to both grandfathered and non-grandfathered group health plans and health insurance issuers offering group health insurance coverage. As with the applicability of the 2004 HIPAA regulations, with respect to individuals who are in a waiting period for coverage before the applicability date, beginning on the first day these rules apply to the plan, any waiting period can no longer apply in a manner that exceeds 90 days. However, as discussed below, the proposed amendment to eliminate the requirement to issue a certificate of creditable coverage is proposed to apply December 31, 2014, so that individuals needing to offset a preexisting condition exclusion under a plan that operates with a plan year beginning later than January 1 would still have access to the certificate for proof of coverage. Comments are invited on these proposed applicability dates.

The August 2012 guidance provided that group health plans and health insurance issuers may rely on the compliance guidance through at least the end of 2014. In the Departments' view, these proposed regulations are consistent with, and no more restrictive on employers than, the August 2012 guidance. Therefore, the Departments will consider compliance with these proposed regulations as compliance with PHS Act section 2708 at least through the end of 2014. (However, for changes outside of PHS Act section 2708 made to existing HIPAA regulations, such as the elimination of the requirement to provide a certificate of creditable coverage, the existing HIPAA regulations continue to apply until amended in new final regulations.) To the extent final regulations or other guidance with respect to the 90-day waiting period limitation is more restrictive on plans and issuers than these proposed regulations, the final regulations or other guidance will not be effective prior to January 1, 2015.

B. *Conforming Changes to Existing Regulations*

Sections 9801 of the Code and 701 of ERISA, and section 2701 of the PHS Act as originally added by HIPAA included requirements pertaining to the application of preexisting condition exclusions and waiting periods, as well as methods of crediting coverage. Final regulations implementing Code section 9801, ERISA section 701, and PHS Act section 2701 (as originally added by HIPAA) were adopted in 2004. The 2004 HIPAA regulations permit limited exclusions of coverage based on a preexisting condition under certain circumstances. PHS Act section 2704, added by the Affordable Care Act and incorporated into ERISA and the Code, amends the HIPAA requirements relating to preexisting conditions to provide that a group health plan and a health insurance issuer offering group or individual health insurance coverage may not impose any preexisting condition exclusion.[10] PHS Act section 2704 and the interim final regulations implementing that section are generally effective with respect to plan years (in the individual market, policy years) beginning on or after January 1, 2014, but for enrollees who are under 19 years of age, this prohibition became effective for plan years (in the individual

[9] *See* 26 CFR 54.9801–3(a)(3)(i); 29 CFR 2590.701–3(a)(3)(i); and 45 CFR 146(a)(3)(i), which would be moved under these proposed rules to 26 CFR 54.9801–2; 29 CFR 2590.701–2; and 45 CFR 144.103.

[10] Affordable Care Act section 1201 also moved those provisions from PHS Act section 2701 to PHS Act section 2704.

market, policy years) beginning on or after September 23, 2010.[11] Therefore, these proposed regulations would amend the 2004 HIPAA regulations implementing Code sections 9801, ERISA section 701, and PHS Act section 2701 (as originally added by HIPAA), to remove provisions superseded by the prohibition on preexisting conditions under PHS Act section 2704 and the implementing regulations. Additionally, these regulations propose to amend examples in 26 CFR Part 54, 29 CFR Part 2590, and 45 CFR Parts 144 and 146 to conform to other changes made by the Affordable Care Act, such as the elimination of lifetime and annual limits under PHS Act section 2711 and its implementing regulations,[12] as well as the provisions governing dependent coverage of children to age 26 under PHS Act section 2714 and its implementing regulations.[13]

C. *Technical Amendment Relating to OPM Multi-State Plan Program and External Review*

Section 1334 of the Affordable Care Act creates the Multi-State Plan Program (MSPP) to foster competition in the Affordable Insurance Exchanges (Exchanges) and directs the U.S. Office of Personnel Management (OPM) to contract with private health insurance issuers to offer at least two multi-state plans (MSPs) on each of the Exchanges in the 50 states and the District of Columbia. Under Affordable Care Act section 1334(a)(4), OPM is to administer this program "in a manner similar to the manner in which" it implements the contracting provisions of the Federal Employee Health Benefits Program (FEHBP). OPM has interpreted Affordable Care Act section 1334(a)(4) to require implementation of a uniform, nationally applicable external review process consistent with the requirements of PHS Act section 2719 for MSPs similar to that administered by OPM under FEHBP,[14] to ensure that the MSPP contract is administered consistently throughout all 51 jurisdictions that would be served by an MSP (as FEHBP currently does).

The "level playing field" requirement in section 1324 of the Affordable Care Act provides that "[n]otwithstanding any other provision of law," requirements under State or Federal law in 13 categories (including appeals) "shall not" apply to "health insurance offered by a private health insurance issuer" if the requirement does not apply to MSPs established under the Affordable Care Act. Non-grandfathered health insurance coverage is generally required to comply with PHS Act section 2719 and its implementing regulations regarding internal claims and appeals and external review processes.[15] As a result, MSPP plans must also so comply, or other non-grandfathered insurance coverage would have to be similarly exempted.[16]

PHS Act section 2719 and its implementing regulations provide that group health plans and health insurance issuers must comply with either a State external review process or the Federal external review process. Generally, if a State has an external review process that meets, at a minimum, the consumer protections set forth in the interim final regulations, then the issuer (or a plan) subject to the State process must comply with the State process.[17] For plans and issuers not subject to an existing State external review process (including self-insured plans), a Federal external review process applies.[18] The statute requires the Departments to establish standards, "through guidance," governing a Federal external review process. Among such guidance that has been issued by the Departments, HHS has established a Federal external review process for self-insured nonfederal governmental health plans, as well as for plans and issuers in States that do not meet the minimum consumer protections in the regulations.

In this rule, the Departments propose to clarify that MSPs will be subject to the Federal external review process under PHS section 2719(b)(2) and paragraph (d) of the internal claims and appeals and external review regulations. In doing so, the Departments interpret section 2719(b)(2) to apply to all plans *not subject to a State's external review process* (emphasis added).[19] OPM's final rule on the establishment of the multi-State plan program[20] requires the MSPP external review process to meet the requirements of PHS Act section 2719 and its implementing regulations.

Additionally, the Departments propose to clarify that the scope of the Federal external review process, as described in paragraph (d)(1)(ii) of the regulations, is the minimum required scope of claims eligible for external review for plans using a Federal external review process, and that Federal external review processes developed in accordance with paragraph (d) may have a scope that exceeds the minimum requirements. For example, OPM stated that the scope of the MSP external review process would allow for appeals

[11] 75 FR 37188 (June 28, 2010).

[12] 75 FR 37188 (June 28, 2010).

[13] 75 FR 27122 (May 13, 2010).

[14] OPM published a final rule on establishment of the MSPP on March 11, 2013 at 78 FR 15559.

[15] The interim final regulations relating to internal claims and appeals and external review processes are codified at 26 CFR 54.9815–2719T, 29 CFR 2590.715–2719, and 45 CFR 147.136. These requirements do not apply to grandfathered health plans. The interim final regulations relating to status as a grandfathered health plan are codified at 26 CFR 54.9815–1251T, 29 CFR 2590.715–1251, and 45 CFR 147.140.

[16] The amendments in these proposed regulations only seek to address the differences that exist between the proposed MSPP external review process and the external review requirements for group health plans and health insurance issuers. While MSPP is also required to comply with the requirements related to internal claims and appeals, OPM's proposed process does not differ from the internal claims and appeals requirements for group health plans and health insurance issuers.

[17] More information on the regulatory requirements for State external review processes, including the regulations, Uniform Health Carrier External Review Model Act promulgated by the National Association of Insurance Commissioners, technical releases, and other guidance, is available at *http://www.dol.gov/ebsa* and *http://cciio.cms.gov*.

[18] More information on the regulatory requirements for the Federal external review process, including the regulations, technical releases, and other guidance, is available at *http://www.dol.gov/ebsa* and *http://cciio.cms.gov*.

[19] We note that this interpretation of section 2719(b)(2) as applicable to MSPs is supported by the fact that Congress directed that the MSPP be implemented by OPM, and OPM is not a state.

[20] *See 45 CFR 800.115(k) and 45 CFR part 800.*

of all disputed claims.[21] This clarification would reiterate that the proposed external review process would meet the minimum requirement for the scope of a Federal external review process under the regulations.

III. Economic Impact and Paperwork Burden

A. *Executive Order 12866 and 13563—Department of Labor and Department of Health and Human Services*

Executive Order 13563 emphasizes the importance of quantifying both costs and benefits, of reducing costs, of harmonizing and streamlining rules, and of promoting flexibility. It also requires federal agencies to develop a plan under which the agencies will periodically review their existing significant regulations to make the agencies' regulatory programs more effective or less burdensome in achieving their regulatory objectives.

Under Executive Order 12866, a regulatory action deemed "significant" is subject to the requirements of the Executive Order and review by the Office of Management and Budget (OMB). Section 3(f) of the Executive Order defines a "significant regulatory action" as an action that is likely to result in a rule (1) having an annual effect on the economy of $100 million or more, or adversely and materially affecting a sector of the economy, productivity, competition, jobs, the environment, public health or safety, or State, local or tribal governments or communities (also referred to as "economically significant"); (2) creating serious inconsistency or otherwise interfering with an action taken or planned by another agency; (3) materially altering the budgetary impacts of entitlement grants, user fees, or loan programs or the rights and obligations of recipients thereof; or (4) raising novel legal or policy issues arising out of legal mandates, the President's priorities, or the principles set forth in the Executive Order.

These proposed regulations are not economically significant within the meaning of section 3(f)(1) of the Executive Order. However, OMB has determined that the actions are significant within the meaning of section 3(f)(4) of the Executive Order. Therefore, OMB has reviewed these proposed regulations, and the Departments have provided the following assessment of their impact.

1. *Summary.*

As stated earlier in this preamble, these proposed regulations would implement PHS Act section 2708, which provides that a group health plan, and a health insurance issuer offering group health insurance coverage, may not apply any waiting period that exceeds 90 days. The proposed regulations define "waiting period" as the period that must pass before coverage for an employee or dependent who is otherwise eligible to enroll under the terms of a group health plan can become effective, which is the same definition used in the 2004 HIPAA regulations. The proposed regulations would generally apply to plan years beginning on or after January 1, 2014, consistent with the statutory effective date of PHS Act section 2708.[22]

The Departments have crafted these proposed regulations to secure the protections intended by Congress in an economically efficient manner. The Departments do not have sufficient data to quantify the regulations' economic cost or benefits; therefore, they have provided a qualitative discussion of their economic impacts and request detailed comment and data that would allow for quantification of the costs, benefits, and transfers that would be brought about by the proposed rule.

2. *Estimated Number of Affected Entities.*

The Departments estimate that 4.1 million new employees receive group health insurance coverage through private sector employers and 1.0 million new employees receive group health insurance coverage through public sector employers annually.[23] The 2012 Kaiser Family Foundation and Health Research and Education Trust Employer Health Benefits Annual Survey (the "2012 Kaiser Survey") finds that only eight percent of covered workers were subject to waiting periods of four months or more.[24] If eight percent of new employees receiving health care from their employers are subject to a waiting period of four months or more, then 408,000 new employees (5.1 million x 0.08) would be affected by this rule.[25] However, the Departments would note that it is unlikely that the survey defines the term "waiting period" in the same manner as these proposed regulations. For example, waiting period may have been defined by reference to an employee's start date, and it seems unlikely that the 2012 Kaiser Survey would have included the clarifications included in these proposed regulations regarding the measurement period for variable-hour employees or the clarification regarding cumulative hours-of-service requirements.

3. *Benefits.*

Before Congress enacted PHS Act section 2708, federal law did not prescribe any limits on waiting periods for group health insurance coverage.

If employees delay health care treatment until the expiration of a prolonged waiting period, detrimental health effects can result, especially for employees and their dependents requiring higher levels of health care, such as older Americans, pregnant women, young children, and those with chronic conditions. This could lead to lower work productivity and missed school days. Low-wage workers also are vulnerable, because they have less income to spend out-of-pocket to cover medical expenses. The Departments anticipate that these proposed regulations can help reduce these effects, although the overall benefit may be limited because—as discussed in

[21] 45 CFR 800.504 (a). See also 78 FR 15559, 15582–15584 (March 11, 2013), the Preamble to the Patient Protection and Affordable Care Act; Establishment of the Multi-State Plan Program for the Affordable Insurance Exchanges; Final Rule.

[22] As stated earlier, the Departments' August 2012 guidance provided that group health plans and health insurance issuers may rely on the compliance guidance through at least the end of 2014. In the Departments' view, these proposed regulations are consistent with, and no more restrictive on employers than, the August 2012 guidance. Therefore, the Departments will consider compliance with these proposed regulations as compliance with PHS Act section 2708 at least through the end of 2014.

[23] This estimate is based upon internal Department of Labor calculations derived from the 2009 Medical Expenditure Panel Survey.

[24] *See e.g.*, Kaiser Family Foundation and Health Research and Education Trust, *Employer Health Benefits 2012 Annual Survey* (2012) available at *http://ehbs.kff.org/pdf/2012/8345.pdf*

[25] Approximately 331,000 private sector employees and 77,000 state and local public sector employees.

greater detail below—a small fraction of employers are expected to offer earlier health insurance coverage as a result of these proposed regulations.

As discussed earlier in this preamble, these proposed regulations would amend the 2004 HIPAA regulations implementing Code sections 9801, ERISA section 701, and PHS Act section 2701 (as originally added by HIPAA) to remove provisions superseded by the prohibition on preexisting conditions under PHS Act section 2704 and the implementing regulations. These amendments would provide a benefit to plans by reducing the burden associated with complying with the several Paperwork Reduction Act information collections that are associated with the superseded regulations. For a discussion of the affected information collections and the estimated cost and burden hour reduction, please see the Paperwork Reduction Act section, below.

4. *Transfers Associated with the Rule.*

The possible transfers associated with this proposed rule would arise if employers begin to pay their portion of health insurance premiums or contributions sooner than they did before the enactment of PHS Act section 2708 and issuance of these proposed regulations. Recipients of the transfers would be covered employees and their dependents who would, if these proposed regulations are finalized, not be subject to excessive waiting periods during which they must forgo health coverage, purchase COBRA continuation coverage, or obtain an individual health insurance policy – all of which are options that could lead to higher out-of-pocket costs for employees to cover their healthcare expenditures. As discussed above, federal law did not limit the duration of waiting periods in the group health plans market before the enactment of PHS Act section 2708.

The Departments do not believe that this rule, on its own, will cause more than a marginal number of employers to offer coverage earlier to their employees because this provision on its own does not require employers to offer coverage and there is significant flexibility afforded to employers in these proposed regulations to maintain or revise their current group health plan eligibility conditions. For example, paragraph (c)(3)(ii) of the proposed regulations provides that if a group health plan or health insurance issuer conditions eligibility on any employee's (part-time or full-time) having completed a number of cumulative hours of service, the eligibility condition is not considered to be designed to avoid compliance with the 90-day waiting period limitation if the cumulative hours-of-service requirement does not exceed 1,200 hours. This is intended to provide plan sponsors with flexibility to continue the common practice of utilizing a probationary or trial period to determine whether a new employee will be able to handle the duties and challenges of the job, while providing protections against excessive waiting periods for such employees. Under these proposed regulations, the plan's waiting period must begin once the new employee satisfies the plan's cumulative hours-of-service requirement and may not exceed 90 days.

Therefore, an employee who must meet a cumulative hours-of-service requirement of 1,200 hours could be employed for ten months[26] before their health coverage becomes effective and only employers that had a waiting period longer than ten months before the enactment of PHS Act section 2708 and these proposed regulations would necessarily incur a transfer for additional coverage. Because the 2012 Kaiser Survey reports that just eight percent of covered workers are in plans with waiting periods of four months or more and the overall average waiting period is just 2.3 months, the Departments are confident that such long waiting periods are rare.

B. *Paperwork Reduction Act*

1. *Department of Labor and Department of the Treasury*

As stated above, Sections 9801 of the Code and 701 of ERISA, and 2701 of the PHS Act as originally added by Health Insurance Portability and Accountability Act of 1996, included requirements pertaining to the application of preexisting conditions exclusions and waiting periods as well as methods of crediting coverage. The 2004 HIPAA regulations (in effect prior to the effective date of these amendments) permit limited exclusions of coverage based on a preexisting condition under certain circumstances.

PHS Act section 2704, added by the Affordable Care Act and incorporated into ERISA and the Code, amends the 2004 HIPAA regulations relating to preexisting conditions to provide that a group health plan and a health insurance issuer offering group or individual health insurance coverage may not impose any preexisting condition exclusion. PHS Act section 2704 and the interim final regulations implementing that section are generally effective with respect to plan years (in the individual market, policy years) beginning on or after January 1, 2014, but for enrollees who are under 19 years of age, this prohibition became effective for plan years (in the individual market, policy years) beginning on or after September 23, 2010. Therefore, these regulations propose to amend the 2004 HIPAA regulations implementing Code sections 9801, ERISA section 701, and PHS Act section 2701 (as originally added by HIPAA), to remove provisions superseded by the prohibition on preexisting conditions under PHS Act section 2704 and the implementing regulations.

The Departments are proposing to discontinue the following Information Collection Requests (ICRs) that are associated with the superseded regulation: The Notice of Preexisting Condition Exclusion under Group Health Plans, which is approved under OMB Control Number 1210–0102 through January 31, 2016, and Establishing Creditable Coverage under Group Health Plans, which is approved under OMB Control Number 1210–0103 through January 31, 2016.

Additionally, the Departments are proposing to revise Final Regulations for Health Coverage Portability for Group Health Plans and Group Health Insurance Issuers under HIPAA Titles I & IV, which is approved under OMB Control Number 1545–1537 through January 31, 2014, to remove the Health Plans Imposing Pre-existing Condition Notification Requirements, Certification Requirements, and Exclusion Period Notification Information Collections within this ICR because they are associated with the superseded regulation.

[26] 1,200 hours/40 hours per week= 30 weeks; 30 weeks *7 days/week= 210 days; 210 days eligibility requirement + 90 day wait period= 300 days.

Discontinuing and revising these ICRs would result in a total burden reduction of approximately 341,000 hours (5,000 hours attributable to OMB Control Number 1210–0102, 74,000 hours attributable to OMB Control Number 1210–0103, and 262,000 hours attributable to OMB Control Number 1545–1537) and a total cost burden reduction of approximately $32.7 million ($1.1 million attributable to OMB Control Number 1210–0102, $12.4 million attributable to OMB Control Number 1210–0103, and $19.2 million attributable to OMB Control Number 1545–1537).

C. *Regulatory Flexibility Act—Department of Labor and Department of Health and Human Services*

The Regulatory Flexibility Act (5 U.S.C. 601 et seq.) (RFA) applies to most Federal rules that are subject to the notice and comment requirements of section 553(b) of the Administrative Procedure Act (5 U.S.C. 551 et seq.). Unless an agency certifies that such a rule will not have a significant economic impact on a substantial number of small entities, section 603 of the RFA requires the agency to present an initial regulatory flexibility analysis at the time of the publication of the notice of proposed rulemaking describing the impact of the rule on small entities. Small entities include small businesses, organizations and governmental jurisdictions.

For purposes of analysis under the RFA, the Departments propose to continue to consider a small entity to be an employee benefit plan with fewer than 100 participants. The basis of this definition is found in section 104(a)(3) of ERISA, which permits the Secretary of Labor to prescribe simplified annual reports for welfare benefit plans that cover fewer than 100 participants.[27]

Further, while some large employers may have small plans, in general, small employers maintain most small plans. Thus, the Departments believe that assessing the impact of these proposed regulations on small plans is an appropriate substitute for evaluating the effect on small entities.

The definition of small entity considered appropriate for this purpose differs, however, from a definition of small business that is based on size standards promulgated by the Small Business Administration (SBA) (13 CFR 121.201) pursuant to the Small Business Act (15 U.S.C. 631 et seq.). The Departments therefore request comments on the appropriateness of the size standard used in evaluating the impact of these proposed regulations on small entities.

The Departments carefully considered the likely impact of the rule on small entities in connection with their assessment under Executive Order 12866. The Departments lack data to focus only on the impacts on small business. However, the Departments believe that the proposed rule includes flexibility that would allow small employers to minimize the transfers in health insurance premiums that they would have to pay to employees.

The Departments hereby certify that these proposed regulations will not have a significant economic impact on a substantial number of small entities. Consistent with the policy of the RFA, the Departments encourage the public to submit comments that would allow the Departments to assess the impacts specifically on small plans or suggest alternative rules that accomplish the stated purpose of PHS Act section 2708 and minimize the impact on small entities.

D. *Special Analyses—Department of the Treasury*

For purposes of the Department of the Treasury, it has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866, as supplemented by Executive Order 13563. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these proposed regulations, and, because these proposed regulations do not impose a collection of information requirement on small entities, a regulatory flexibility analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to Code section 7805(f), this notice of proposed rulemaking has been submitted to the Small Business Administration for comment on its impact on small business.

E. *Congressional Review Act*

These proposed regulations are subject to the Congressional Review Act provisions of the Small Business Regulatory Enforcement Fairness Act of 1996 (5 U.S.C. 801 et seq.) and, if finalized, will be transmitted to the Congress and the Comptroller General for review.

F. *Unfunded Mandates Reform Act*

For purposes of the Unfunded Mandates Reform Act of 1995 (Pub. L. 104–4), as well as Executive Order 12875, these proposed rules do not include any proposed federal mandate that may result in expenditures by state, local, or tribal governments, or by the private sector, of $100 million or more adjusted for inflation ($141 million in 2013).

G. *Federalism Statement—Department of Labor and Department of Health and Human Services*

Executive Order 13132 outlines fundamental principles of federalism, and requires the adherence to specific criteria by Federal agencies in the process of their formulation and implementation of policies that have "substantial direct effects" on the States, the relationship between the national government and States, or on the distribution of power and responsibilities among the various levels of government. Federal agencies promulgating regulations that have these federalism implications must consult with State and local officials, and describe the extent of their consultation and the nature of the concerns of State and local officials in the preamble to the regulation.

In the Departments' view, these proposed regulations have federalism implications, because they have direct effects

[27] Under ERISA section 104(a)(2), the Secretary may also provide exemptions or simplified reporting and disclosure requirements for pension plans. Pursuant to the authority of ERISA section 104(a)(3), the Department of Labor has previously issued at 29 CFR 2520.104–20, 2520.104–21, 2520.104–41, 2520.104–46, and 2520.104b–10 certain simplified reporting provisions and limited exemptions from reporting and disclosure requirements for small plans, including unfunded or insured welfare plans, that cover fewer than 100 participants and satisfy certain other requirements.

on the States, the relationship between the national government and States, or on the distribution of power and responsibilities among various levels of government. In general, through section 514, ERISA supersedes State laws to the extent that they relate to any covered employee benefit plan, and preserves State laws that regulate insurance, banking, or securities. While ERISA prohibits States from regulating a plan as an insurance or investment company or bank, the preemption provisions of ERISA section 731 and PHS Act section 2724 (implemented in 29 CFR 2590.731(a) and 45 CFR 146.143(a)) apply so that the HIPAA requirements (including those of the Affordable Care Act) are not to be "construed to supersede any provision of State law which establishes, implements, or continues in effect any standard or requirement solely relating to health insurance issuers in connection with group health insurance coverage except to the extent that such standard or requirement prevents the application of a requirement" of a federal standard. The conference report accompanying HIPAA indicates that this is intended to be the "narrowest" preemption of State laws. (See House Conf. Rep. No. 104–736, at 205, reprinted in 1996 U.S. Code Cong. & Admin. News 2018.)

States may continue to apply State law requirements except to the extent that such requirements prevent the application of the Affordable Care Act requirements that are the subject of this rulemaking. State insurance laws that are more stringent than the Federal requirements are unlikely to "prevent the application of" the Affordable Care Act, and be preempted. Accordingly, States have significant latitude to impose requirements on health insurance issuers that are more restrictive than the Federal law.

Guidance conveying this interpretation was published in the **Federal Register** on April 8, 1997 (62 FR 16904), and December 30, 2004 (69 FR 78720), and these proposed rules would clarify and implement the statute's minimum standards and would not significantly reduce the discretion given the states by the statute.

In compliance with the requirement of Executive Order 13132 that agencies examine closely any policies that may have federalism implications or limit the policy making discretion of the States, the Departments have engaged in efforts to consult with and work cooperatively with affected State and local officials, including attending conferences of the National Association of Insurance Commissioners and consulting with State insurance officials on an individual basis.

Throughout the process of developing these proposed regulations, to the extent feasible within the specific preemption provisions of HIPAA as it applies to the Affordable Care Act, the Departments have attempted to balance the States' interests in regulating health insurance issuers, and Congress' intent to provide uniform minimum protections to consumers in every State. By doing so, it is the Departments' view that they have complied with the requirements of Executive Order 13132.

IV. Statutory Authority

The Department of the Treasury regulations are proposed to be adopted pursuant to the authority contained in sections 7805 and 9833 of the Code.

The Department of Labor regulations are proposed to be adopted pursuant to the authority contained in 29 U.S.C. 1027, 1059, 1135, 1161–1168, 1169, 1181–1183, 1181 note, 1185, 1185a, 1185b, 1185d, 1191, 1191a, 1191b, and 1191c; sec. 101(g), Public Law104–191, 110 Stat. 1936; sec. 401(b), Public Law 105–200, 112 Stat. 645 (42 U.S.C. 651 note); sec. 512(d), Public Law 110–343, 122 Stat. 3881; sec. 1001, 1201, and 1562(e), Public Law 111–148, 124 Stat. 119, as amended by Public Law 111–152, 124 Stat. 1029; Secretary of Labor's Order 3–2010, 75 FR 55354 (September 10, 2010).

The Department of Health and Human Services regulations are proposed to be adopted, with respect to 45 CFR Part 146, pursuant to the authority contained in sections 2702 through 2705, 2711 through 2723, 2791, and 2792 of the PHS Act (42 U.S.C. 300gg–1 through 300gg–5, 300gg–11 through 300gg–23, 300gg–91, and 300gg–92), and, with respect to 45 CFR Part 147, pursuant to the authority contained in sections 2701 through 2763, 2791, and 2792 of the PHS Act (42 U.S.C. 300gg through 300gg–63, 300gg–91, and 300gg–92), as amended.

* * * * *

Steven T. Miller,
Deputy Commissioner for Services and Enforcement, Internal Revenue Service.

Signed this *14th* day of *March*, 2013.

Phyllis C. Borzi,
Assistant Secretary, Employee Benefits Security Administration, Department of Labor.

Dated *March 13, 2013*

Marilyn Tavenner,
Acting Administrator,
Centers for Medicare &
Medicaid Services.

Dated *March 14, 2013*

Kathleen Sebelius,
Secretary,
Department of Health and
Human Services.

DEPARTMENT OF THE TREASURY
Internal Revenue Service

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

PART 54—PENSION EXCISE TAXES

Paragraph 1. The authority citation for Part 54 is amended by adding an entry for §54.9815–2708 in numerical order to read in part as follows:

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

Section 54.9815–2708 is also issued under 26 U.S.C. 9833.

Par. 2. Section 54.9801–1 is amended by revising paragraph (b) to read as follows:

§54.9801–1 Basis and scope.

* * * * *

(b) *Scope*. A group health plan or health insurance issuer offering group health insurance coverage may provide greater rights to participants and beneficiaries than those set forth in the portability and market reform sections of this part 54. This part 54 sets forth minimum requirements for group health plans and group health insurance issuers offering group health insurance coverage concerning certain consumer protections of the Health Insurance Portability and Accountability Act (HIPAA), including special enrollment periods and the prohibition against discrimination based on a health factor, as amended by the Patient Protection and Affordable Care Act (Affordable Care Act). Other consumer protection provisions, including other protections provided by the Affordable Care Act and the Mental Health Parity and Addiction Equity Act are set forth in this part 54.

* * * * *

Par. 3. Section 54.9801–2 is amended by revising the definitions of "*enrollment date*", "*late enrollment*", and "*waiting period*", and by adding definitions of "*first day of coverage*" and "*late enrollee*" in alphabetical order, to read as follows:

§54.9801–2 Definitions.

* * * * *

Enrollment date means the first day of coverage or, if there is a waiting period, the first day of the waiting period. If an individual receiving benefits under a group health plan changes benefit packages, or if the plan changes group health insurance issuers, the individual's enrollment date does not change.

* * * * *

First day of coverage means, in the case of an individual covered for benefits under a group health plan, the first day of coverage under the plan and, in the case of an individual covered by health insurance coverage in the individual market, the first day of coverage under the policy or contract.

* * * * *

Late enrollee means an individual whose enrollment in a plan is a late enrollment.

Late enrollment means enrollment of an individual under a group health plan other than the earliest date on which coverage can become effective for the individual under the terms of the plan, or through special enrollment. (For rules relating to special enrollment, see §54.9801–6.) If an individual ceases to be eligible for coverage under a plan, and then subsequently becomes eligible for coverage under the plan, only the individual's most recent period of eligibility is taken into account in determining whether the individual is a late enrollee under the plan with respect to the most recent period of coverage. Similar rules apply if an individual again becomes eligible for coverage following a suspension of coverage that applied generally under the plan.

* * * * *

Waiting period means *waiting period* within the meaning of §54.9815–2708(b).

* * * * *

Par. 4. Section 54.9801–3 is amended by:

A. Removing paragraphs (a)(2), (a)(3), (c), (d), (e) and (f).

B. Revising the heading to paragraph (a).

C. Removing paragraph (a)(1) introductory text, and redesignating paragraphs (a)(1)(i) and (a)(1)(ii) as paragraphs (a)(1) and (a)(2).

D. Amending paragraph (a)(2) by revising paragraph (ii) of Examples 1 and 2, by revising Example 3 and Example 4, and by revising paragraph (ii) of Examples 5, 6, 7 and 8.

E. Revising paragraph (b).

The revisions read as follows:

§54.9801–3 Limitations on preexisting condition exclusion period.

(a) *Preexisting condition exclusion defined*—

* * * * *

(2) * * *

Example 1. * * *

(ii) *Conclusion*. In this *Example 1*, the exclusion of benefits for any prosthesis if the body part was lost before the effective date of coverage is a preexisting condition exclusion because it operates to exclude benefits for a condition based on the fact that the condition was present before the effective date of coverage under the policy. The exclusion of benefits, therefore, is prohibited.

Example 2. * * *

(ii) *Conclusion*. In this *Example 2*, the plan provision excluding cosmetic surgery benefits for individuals injured before enrolling in the plan is a preexisting condition exclusion because it operates to exclude benefits relating to a condition based on the fact that the condition was present before the effective date of coverage. The plan provision, therefore, is prohibited.

Example 3. (i) *Facts*. A group health plan provides coverage for the treatment of diabetes, generally not subject to any requirement to obtain an approval for a treatment plan. However, if an individual was diagnosed with diabetes before the effective date of coverage under the plan, diabetes coverage is subject to a requirement to obtain approval of a treatment plan in advance.

(ii) *Conclusion*. In this *Example 3*, the requirement to obtain advance approval of a treatment plan is a preexisting condition exclusion because it limits benefits for a condition based on the fact that the condition was present before the effective date of coverage. The plan provision, therefore, is prohibited.

Example 4. (i) *Facts*. A group health plan provides coverage for three infertility treatments. The plan counts against the three-treatment limit benefits provided under prior health coverage.

(ii) *Conclusion*. In this *Example 4*, counting benefits for a specific condition provided under prior health coverage against a treatment limit for that condition is a preexisting condition exclusion because it operates to limit benefits for a condition based on the fact that the condition was present before the effective date of coverage. The plan provision, therefore, is prohibited.

Example 5. * * *

(ii) *Conclusion*. In this *Example 5*, the requirement to be covered under the plan for 12 months to be eligible for pregnancy benefits is a subterfuge for a preexisting condition exclusion because it is designed to exclude benefits for a condition (pregnancy) that arose before the effective date of coverage. The plan provision, therefore, is prohibited.

Example 6. * * *

(ii) *Conclusion*. In this *Example 6*, the exclusion of coverage for treatment of congenital heart conditions is a preexisting condition exclusion because it operates to exclude benefits relating to a condition based on the fact that the condition was present before the effective date of coverage. The plan provision, therefore, is prohibited.

Example 7. * * *

(ii) *Conclusion*. In this *Example 7*, the exclusion of coverage for treatment of cleft palate is not a preexisting condition exclusion because the exclusion applies regardless of when the condition arose relative to the effective date of coverage. The plan provision, therefore, is not prohibited. (But see 45 CFR 147.150, which may require coverage of cleft palate as an essential health benefit for health insurance coverage in the individual or small group market).

Example 8. * * *

(ii) *Conclusion*. In this *Example 8*, the exclusion of coverage for treatment of cleft palate for individuals who have not been covered under the plan from the date of birth operates to exclude benefits in relation to a condition based on the fact that the condition was present before the effective date of coverage. The plan provision, therefore, is prohibited.

* * * * *

(b) *General rules*. *See* §54.9815–2704T for rules prohibiting the imposition of a preexisting condition exclusion.

Par. 5. Section 54.9801–4 is amended by removing paragraphs (a)(3) and (c), and revising paragraph (b) to read as follows:

§54.9801–4 Rules relating to creditable coverage.

* * * * *

(b) *Counting creditable coverage rules superseded by prohibition on preexisting condition exclusion*. *See* §54.9815–2704T for rules prohibiting the imposition of a preexisting condition exclusion.

Par. 6. Section 54.9801–5 is revised to read as follows:

§54.9801–5 Evidence of creditable coverage.

(a) *In general*. The rules for providing certificates of creditable coverage and demonstrating creditable coverage have been superseded by the prohibition on preexisting condition exclusions. *See* §54.9815–2704T for rules prohibiting the imposition of a preexisting condition exclusion.

(b) *Applicability*. The amendments made under this section apply beginning December 31, 2014.

Par. 7. Section 54.9801–6 is amended by removing paragraph (a)(3)(i)(E) and revising paragraphs (a)(3)(i)(C), (a)(3)(i)(D), (a)(4)(i) and (d)(2) to read as follows:

§54.9801–6 Special enrollment periods.

* * * * *

(a) * * *

(3) * * *

(i) * * *

(C) In the case of coverage offered through an HMO, or other arrangement, in the group market that does not provide benefits to individuals who no longer reside, live, or work in a service area, loss of coverage because an individual no longer resides, lives, or works in the service area (whether or not within the choice of the individual), and no other benefit package is available to the individual; and

(D) A situation in which a plan no longer offers any benefits to the class of similarly situated individuals (as described in §54.9802–1(d)) that includes the individual.

* * * * *

(4) * * *

(i) A plan or issuer must allow an employee a period of at least 30 days after an event described in paragraph (a)(3) of this section to request enrollment (for the employee or the employee's dependent).

* * * * *

(d) * * *

(2) Special enrollees must be offered all the benefit packages available to similarly situated individuals who enroll when first eligible. For this purpose, any difference in benefits or cost-sharing requirements for different individuals constitutes a different benefit package. In addition, a special enrollee cannot be required to pay more for coverage than a similarly situated individual who enrolls in the same coverage when first eligible.

* * * * *

Par. 8. Section 54.9802–1 is amended by:

A. Removing paragraph (b)(3) and revising paragraphs (b)(1)(i) and (b)(2)(i)(B).

B. Revising Example 1, paragraph (i) of Example 2, paragraph (ii) of Example 4, paragraph (ii) of Example 5, and removing Example 8 in paragraph (b)(2)(i)(D).

C. Revising Example 2, and paragraph (i) of Example 5, in paragraph (d)(4).

D. Revising paragraph (ii) of Example 2 in paragraph (e)(2)(i)(B).

E. Revising Example 1 in paragraph (g)(1)(ii).

The revisions read as follows:

§54.9802–1 Prohibiting discrimination against participants and beneficiaries based on a health factor.

* * * * *

(b) * * *

(1) * * *

(i) A group health plan may not establish any rule for eligibility (including continued eligibility) of any individual to enroll for benefits under the terms of the plan that discriminates based on any health factor that relates to that individual or a dependent of that individual. This rule is subject to the provisions of paragraph (b)(2) of this section (explaining how this rule applies to benefits), paragraph (d) of this section (containing rules for establishing groups of similarly situated individuals), paragraph (e) of this section (relating to nonconfinement, actively-at-work, and other service requirements), paragraph (f) of this section (relating to wellness programs), and paragraph (g) of this section (permitting favorable treatment of individuals with adverse health factors).

* * * * *

(2) * * *

(i) * * *

(B) However, benefits provided under a plan must be uniformly available to all similarly situated individuals (as described in paragraph (d) of this section). Likewise, any restriction on a benefit or benefits must apply uniformly to all similarly situated individuals and must not be directed at individual participants or beneficiaries based on any health factor of the participants or beneficiaries (determined based on all the relevant facts and circumstances). Thus, for example, a plan may limit or exclude benefits in relation to a specific disease or condition, limit or exclude benefits for certain types of treatments or drugs, or limit or exclude benefits based on a determination of whether the benefits are experimental or not medically necessary, but only if the benefit limitation or exclusion applies uniformly to all similarly situated individuals and is not directed at individual participants or beneficiaries based on any health factor of the participants or beneficiaries. In addition, a plan may require the satisfaction of a deductible, copayment, coinsurance, or other cost-sharing requirement in order to obtain a benefit if the limit or cost-sharing requirement applies uniformly to all similarly situated individuals and is not directed at individual participants or beneficiaries based on any health factor of the participants or beneficiaries. In the case of a cost-sharing requirement, see also paragraph (b)(2)(ii) of this section, which permits variances in the application of a cost-sharing mechanism made available under a wellness program. (Whether any plan provision or practice with respect to benefits complies with this paragraph (b)(2)(i) does not affect whether the provision or practice is permitted under ERISA, the Affordable Care Act (including the requirements related to essential health benefits), the Americans with Disabilities Act, or any other law, whether State or Federal.)

* * * * *

(D) * * *

Example 1. (i) *Facts.* A group health plan applies a $10,000 annual limit on a specific covered benefit that is not an essential health benefit to each participant or beneficiary covered under the plan. The limit is not directed at individual participants or beneficiaries.

(ii) *Conclusion.* In this *Example 1*, the limit does not violate this paragraph (b)(2)(i) because coverage of the specific, non-essential health benefit up to $10,000 is available uniformly to each participant and beneficiary under the plan and because the limit is applied uniformly to all participants and beneficiaries and is not directed at individual participants or beneficiaries.

Example 2. (i) *Facts.* A group health plan has a $500 deductible on all benefits for participants covered under the plan. Participant B files a claim for the treatment of AIDS. At the next corporate board meeting of the plan sponsor, the claim is discussed. Shortly thereafter, the plan is modified to impose a $2,000 deductible on benefits for the treatment of AIDS, effective before the beginning of the next plan year.

* * * * *

Example 4. * * *

(ii) *Conclusion.* In this *Example 4*, the limit does not violate this paragraph (b)(2)(i) because $2,000 of benefits for the treatment of TMJ are available uniformly to all similarly situated individuals and a plan may limit benefits covered in relation to a specific disease or condition if the limit applies uniformly to all similarly situated individuals and is not directed at individual participants or beneficiaries. (However, applying a lifetime limit on TMJ may violate § 54.9815–2711, if TMJ coverage is an essential health benefit. This example does not address whether the plan provision is permissible under any other applicable law, including PHS Act section 2711 or the Americans with Disabilities Act.)

Example 5. * * *

(ii) *Conclusion.* In this *Example 5*, the lower lifetime limit for participants and beneficiaries with a congenital heart defect violates this paragraph (b)(2)(i) because benefits under the plan are not uniformly available to all similarly situated individuals and the plan's lifetime limit on benefits does not apply uniformly to all similarly situated individuals. Additionally, this plan provision is prohibited under §54.9815–2711 because it imposes a lifetime limit on essential health benefits.

* * * * *

(d) * * *

(4) * * *

Example 2. (i) *Facts.* Under a group health plan, coverage is made available to employees, their spouses, and their children. However, coverage is made available to a child only if the child is under age 26 (or under age 29 if the child is continuously enrolled full-time in an institution of higher learning (full-time students)). There is no evidence to suggest that these classifications are directed at individual participants or beneficiaries.

(ii) *Conclusion.* In this Example 2, treating spouses and children differently by imposing an age limitation on children, but not on spouses, is permitted under this paragraph (d). Specifically, the distinction between spouses and children is permitted under paragraph (d)(2) of this section and is not prohibited under paragraph (d)(3) of this section because it is not directed at individual participants or beneficiaries. It is also permissible to treat children who are under age 26 (or full-time students under age 29) as a group of similarly situated individuals separate from those who are age 26 or older (or age 29 or older if they are not full-time students) because the classification is permitted under paragraph (d)(2) of this section and is not directed at individual participants or beneficiaries.

* * * * *

Example 5. (i) *Facts.* An employer sponsors a group health plan that provides the same benefit package to all seven employees of the employer. Six of the seven employees have the same job title and responsibilities, but Employee *G* has a different job title and different responsibilities. After *G* files an expensive claim for benefits under the plan, coverage under the plan is modified so that employees with *G*'s job title receive a different benefit package that includes a higher deductible than in the benefit package made available to the other six employees.

* * * * *

(e) * * *

(2) * * *

(i) * * *

(B) * * *

Example 2. * * *

(ii) *Conclusion.* In this Example 2, the plan violates this paragraph (e)(2) (and thus also paragraph (b) of this section) because the 90-day continuous service requirement is a rule for eligibility based on whether an individual is actively at work. However, the plan would not violate this paragraph (e)(2) or paragraph (b) of this section if, under the plan, an absence due to any health factor is not considered an absence for purposes of measuring 90 days of continuous service. (In addition, any eligibility provision that is time-based must comply with the requirements of PHS Act section 2708 and its implementing regulations.)

* * * * *

(g) * * *

(1) * * *

(ii) * * *

Example 1. (i) *Facts.* An employer sponsors a group health plan that generally is available to employees, spouses of employees, and dependent children until age 26. However, dependent children who are disabled are eligible for coverage beyond age 26.

(ii) *Conclusion.* In this Example 1, the plan provision allowing coverage for disabled dependent children beyond age 26 satisfies this paragraph (g)(1) (and thus does not violate this section).

* * * * *

Par. 9. Section 54.9815–2708 is added to read as follows:

§54.9815–2708 Prohibition on waiting periods that exceed 90 days.

(a) *General rule*. A group health plan, and a health insurance issuer offering group health insurance coverage, must not apply any waiting period that exceeds 90 days, in accordance with the rules of this section. If, under the terms of a plan, an employee can elect coverage that would begin on a date that is not later than the end of the 90-day waiting period, this paragraph (a) is considered satisfied. Accordingly, a plan or issuer in that case will not be considered to have violated this paragraph (a) solely because employees (or other classes of participants) may take additional time (beyond the end of the 90-day waiting period) to elect coverage.

(b) *Waiting period defined*. For purposes of this part, a waiting period is the period that must pass before coverage for an employee or dependent who is otherwise eligible to enroll under the terms of a group health plan can become effective. If an employee or dependent enrolls as a late enrollee (as defined under §54.9801–2) or special enrollee (as described in §54.9801–6), any period before such late or special enrollment is not a waiting period.

(c) *Relation to a plan's eligibility criteria* — (1) Except as provided in paragraphs (c)(2) and (c)(3) of this section, being otherwise eligible to enroll under the terms of a group health plan means having met the plan's substantive eligibility conditions (such as, for example, being in an eligible job classification or achieving job-related licensure requirements specified in the plan's terms). Moreover, except as provided in paragraphs (c)(2) and (c)(3) of this section, nothing in this section requires a plan sponsor to offer coverage to any particular employee or class of employees (including, for example, part-time employees). Instead, this section prohibits requiring otherwise eligible participants and beneficiaries to wait more than 90 days before coverage is effective. (While a substantive eligibility condition that denies coverage to employees may be permissible under this section, a failure by an applicable large employer (as defined in section 4980H) to offer coverage to a full-time employee might, for example, nonetheless give rise to an assessable payment under section 4980H and its implementing regulations.)

(2) *Eligibility conditions based solely on the lapse of time*. Eligibility conditions that are based solely on the lapse of a time period are permissible for no more than 90 days.

(3) *Other conditions for eligibility*. Other conditions for eligibility under the terms of a group health plan are generally permissible under PHS Act section 2708, unless the condition is designed to avoid compliance with the 90-day waiting period limitation, determined in accordance with the rules of this paragraph (c)(3).

(i) *Application to variable-hour employees in cases in which a specified number of hours of service per period is a plan eligibility condition*. If a group health plan conditions eligibility on an employee regularly having a specified number of hours of service per period (or working full-time), and it cannot be determined that a newly-hired employee is reasonably expected to regularly work that number of hours per period (or work full-time), the plan may take a reasonable period of time, not to exceed 12 months and beginning on any date between the employee's start day and the first day of the first calendar month following the employee's start date, to determine whether the employee meets the plan's eligibility condition. Except in cases in which a waiting period that exceeds 90 days is imposed in addition to a measurement period, the time period for determining whether such an employee meets the plan's eligibility condition will not be considered to be designed to avoid compliance with the 90-day waiting period limitation if coverage is made effective no later than 13 months from the employee's start date, plus if the employee's start date is not the first day of a calendar month, the time remaining until the first day of the next calendar month.

(ii) *Cumulative service requirements*. If a group health plan or health insurance issuer conditions eligibility on an employee's having completed a number of cumulative hours of service, the eligibility condition is not considered to be designed to avoid compliance with the 90-day waiting period limitation if the cumulative hours-of-service requirement does not exceed 1,200 hours.

(d) *Counting days*. Under this section, all calendar days are counted beginning on the enrollment date (as defined in §54.9801–2), including weekends and holidays. If, in the case of a plan or issuer imposing a 90-day waiting period, the 91st day is a weekend or holiday, the plan or issuer may choose to permit coverage to become effective earlier than the 91st day, for administrative convenience. Similarly, plans and issuers that do not want to start coverage in the middle of a month (or pay period) may choose to permit coverage to become effective earlier than the 91st day, for administrative convenience. For example, a plan may impose a waiting period of 60 days plus a fraction of a month (or pay period) until the first day of the next month (or pay period). However, a plan or issuer that extends the effective date of coverage beyond the 91st day fails to comply with the 90-day waiting period limitation.

(e) *Examples*. The rules of this section are illustrated by the following examples:

Example 1. (i) *Facts*. A group health plan provides that full-time employees are eligible for coverage under the plan. Employee *A* begins employment as a full-time employee on January 19.

(ii) *Conclusion*. In this *Example 1*, any waiting period for *A* would begin on January 19 and may not exceed 90 days. Coverage under the plan must become effective no later than April 19 (assuming February lasts 28 days).

Example 2. (i) *Facts*. A group health plan provides that only employees with job title *M* are eligible for coverage under the plan. Employee *B* begins employment in job title *L* on January 30.

(ii) *Conclusion*. In this *Example 2*, *B* is not eligible for coverage under the plan, and the period while *B* is working in job title *L* and therefore not in an eligible class of employees is not part of a waiting period under this section.

Example 3. (i) *Facts*. Same facts as *Example 2*, except that *B* transfers to a new position with job title *M* on April 11.

(ii) *Conclusion*. In this *Example 3*, *B* becomes eligible for coverage on April 11, but for the waiting period. Any waiting period for *B* begins on April 11 and may not exceed 90 days. Coverage under the plan must become effective no later than July 10.

Example 4. (i) *Facts*. A group health plan provides that only employees who have completed specified training and achieved specified certifications are eligible for coverage under the plan. Employee *C* is hired on May 3 and meets the plan's eligibility criteria on September 22.

(ii) *Conclusion*. In this *Example 4*, *C* becomes eligible for coverage on September 22, but for the waiting period. Any waiting period for *C* would begin on September 22 and may not exceed 90 days. Coverage under the plan must become effective no later than December 21.

Example 5. (i) *Facts*. A group health plan provides that employees are eligible for coverage after one year of service.

(ii) *Conclusion*. In this *Example 5*, the plan's eligibility condition is based solely on the lapse of time and, therefore, is impermissible under paragraph (c)(2) of this section because it exceeds 90 days.

Example 6. (i) *Facts*. Employer *W*'s group health plan provides for coverage to begin on the first day of the first payroll period on or after the date an employee is hired and completes the applicable enrollment forms. Enrollment forms are distributed on an employee's start date and may be completed within 90 days. Employee *D* is hired and starts on October 31, which is the first day of a pay period. *D* completes the enrollment forms and submits them on the 90^{th} day after *D*'s start date. Coverage is made effective 7 days later, which is the first day of the next pay period.

(ii) *Conclusion*. In this *Example 6*, under the terms of *W*'s plan, coverage may become effective as early as October 31, depending on when *D* completes the applicable enrollment forms. Under the terms of the plan, when coverage becomes effective is dependent solely on the length of time taken by *D* to complete the enrollment materials. Therefore, under the terms of the plan, *D* may elect coverage that would begin on a date that does not exceed the 90-day waiting period limitation, and the plan complies with this section.

Example 7. (i) *Facts*. Under Employer *Y*'s group health plan, only employees who are full-time (defined under the plan as regularly averaging 30 hours of service per week) are eligible for coverage. Employee *E* begins employment for Employer *Y* on November 26 of Year 1. *E*'s hours are reasonably expected to vary, with an opportunity to work between 20 and 45 hours per week, depending on shift availability and *E*'s availability. Therefore, it cannot be determined at *E*'s start date that *E* is reasonably expected to work full-time. Under the terms of the plan, variable-hour employees, such as *E*, are eligible to enroll in the plan if they are determined to be a full-time employee after a measurement period of 12 months that begins on the employee's start date. Coverage is made effective no later than the first day of the first calendar month after the applicable enrollment forms are received. *E*'s 12-month measurement period ends November 25 of Year 2. *E* is determined to be a full-time employee and is notified of *E*'s plan eligibility. If *E* then elects coverage, *E*'s first day of coverage will be January 1 of Year 3.

(ii) *Conclusion*. In this *Example 7*, the measurement period is permissible because it is not considered to be designed to avoid compliance with the 90-day waiting period limitation. The plan may use a reasonable period of time to determine whether a variable-hour employee is a full-time employee, provided the period of time is no longer than 12 months and begins on a date between the employee's start date and the first day of the next calendar month, provided coverage is made effective no later than 13 months from *E*'s start date (plus if the employee's start date is not the first day of a calendar month, the time remaining until the first day of the next calendar month) and provided that, in addition to the measurement period, no more than 90 days elapse prior to the employee's eligibility for coverage.

Example 8. (i) *Facts*. Employee *F* begins working 25 hours per week for Employer *Z* on January 6 and is considered a part-time employee for purposes of *Z*'s group health plan. *Z* sponsors a group health plan that provides coverage to part-time employees after they have completed a cumulative 1,200 hours of service. *F* satisfies the plan's cumulative hours of service condition on December 15.

(ii) *Conclusion*. In this *Example 8*, the cumulative hours of service condition with respect to part-time employees is not considered to be designed to avoid compliance with the 90-day waiting period limitation. Accordingly, coverage for *F* under the plan must begin no later than the 91st day after *F* completes 1,200 hours. (If the plan's cumulative hours-of-service requirement was more than 1,200 hours, the requirement would be considered to be designed to avoid compliance with the 90-day waiting period limitation.)

(f) *Special rule for health insurance issuers*. To the extent coverage under a group health plan is insured by a health insurance issuer, the issuer is permitted to rely on the eligibility information reported to it by the employer (or other plan sponsor) and will not be considered to violate the requirements of this section with respect to its administration of any waiting period, if both of the following conditions are satisfied:

(1) The issuer requires the plan sponsor to make a representation regarding the terms of any eligibility conditions or waiting periods imposed by the plan sponsor before an individual is eligible to become covered under the terms of the employer's plan (and requires the plan sponsor to update this representation with any changes); and

(2) The issuer has no specific knowledge of the imposition of a waiting period that would exceed the permitted 90-day period.

(g) *No effect on other laws*. Compliance with this section is not determinative of compliance with any other provision of State or Federal law (including ERISA, the Code, or other provisions of the Patient Protection and Affordable Care Act). *See e.g.*, §54.9802–1, which prohibits discrimination in eligibility for coverage based on a health factor, and section 4980H, which generally requires applicable large employers to offer coverage to full-time employees and their dependents or make an assessable payment.

(h) *Applicability date* — (1) *In general*. The provisions of this section apply for plan years beginning on or after January 1, 2014. *See* §54.9815–1251T providing that the prohibition on waiting periods exceeding 90 days applies to all group health plans and health insurance issuers, including grandfathered health plans.

(2) *Application to individuals in a waiting period prior to the applicability date* — (i) With respect to individuals who are in a waiting period for coverage before the applicability date of this section, beginning on the first day the section applies, the waiting period can no longer apply to the individual if it would exceed 90 days with respect to the individual.

(ii) This paragraph (h)(2) is illustrated by the following example:

Example. (i) *Facts*. A group health plan is a calendar year plan. Prior to January 1, 2014, the plan provides that full-time employees are eligible for coverage after a 6-month waiting period. Employee *A* begins work as a full-time employee on October 1, 2013.

(ii) *Conclusion*. In this *Example 1*, the first day of A's waiting period is October 1, 2013 because that is the first day *A* is otherwise eligible to enroll under the plan's substantive eligibility provisions, but for the waiting period. Beginning January 1, 2014, the plan may not apply a waiting period that exceeds 90 days. Accordingly, *A* must be given the opportunity to elect coverage that begins no later than January 1, 2014 (which is 93 days after *A*'s start date) because otherwise, on January 1, 2014, the plan would be applying a waiting period that exceeds 90 days. The plan is not required to make coverage effective before January 1, 2014 under the rules of this section.

Par. 10. Section 54.9815–2719T is amended by adding a sentence to the end of the introductory text of paragraph (d) and revising paragraph (d)(1)(i) to read as follows:

§54.9815–2719T Internal claims and appeals and external review processes.

* * * * *

(d) * * * A Multi State Plan or MSP, as defined by 45 CFR 800.20, must provide an effective Federal external review process in accordance with this paragraph (d).

(1) * * *

(i) *In general*. Subject to the suspension provision in paragraph (d)(1)(ii) of this section and except to the extent provided otherwise by the Secretary in guidance, the Federal external review process established pursuant to this paragraph (d) applies, at a minimum, to any adverse benefit determination or final adverse benefit determination (as defined in paragraphs (a)(2)(i) and (a)(2)(v) of this section), except that a denial, reduction, termination, or a failure to provide payment for a benefit based on a determination that a participant or beneficiary fails to meet the requirements for eligibility under the terms of a group health plan is not eligible for the Federal external review process under this paragraph (d).

* * * * *

Par. 11. Section 54.9831–1 is amended by removing paragraph (b)(2)(i), and redesignating paragraphs (b)(2)(ii) through (b)(2)(viii) as (b)(2)(i) through (b)(2)(vii).

(Filed by the Office of the Federal Register on March 18, 2013, 4:15 p.m., and published in the issue of the Federal Register for March 21, 2013, 78 FR 17313)

Definition of Terms

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

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

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

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

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

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

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

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified* and *superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case, the previously published ruling is first modified and then, as modified, is superseded.

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

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

Abbreviations

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

A—Individual.
Acq.—Acquiescence.
B—Individual.
BE—Beneficiary.
BK—Bank.
B.T.A.—Board of Tax Appeals.
C—Individual.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
CI—City.
COOP—Cooperative.
Ct.D.—Court Decision.
CY—County.
D—Decedent.
DC—Dummy Corporation.
DE—Donee.
Del. Order—Delegation Order.
DISC—Domestic International Sales Corporation.
DR—Donor.
E—Estate.
EE—Employee.
E.O.—Executive Order.
ER—Employer.
ERISA—Employee Retirement Income Security Act.
EX—Executor.
F—Fiduciary.
FC—Foreign Country.
FICA—Federal Insurance Contributions Act.
FISC—Foreign International Sales Company.
FPH—Foreign Personal Holding Company.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
FX—Foreign corporation.
G.C.M.—Chief Counsel's Memorandum.
GE—Grantee.
GP—General Partner.
GR—Grantor.
IC—Insurance Company.
I.R.B.—Internal Revenue Bulletin.
LE—Lessee.
LP—Limited Partner.
LR—Lessor.
M—Minor.
Nonacq.—Nonacquiescence.
O—Organization.
P—Parent Corporation.
PHC—Personal Holding Company.
PO—Possession of the U.S.
PR—Partner.
PRS—Partnership.
PTE—Prohibited Transaction Exemption.
Pub. L.—Public Law.
REIT—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
S—Subsidiary.
S.P.R.—Statement of Procedural Rules.
Stat.—Statutes at Large.
T—Target Corporation.
T.C.—Tax Court.
T.D. —Treasury Decision.
TFE—Transferee.
TFR—Transferor.
T.I.R.—Technical Information Release.
TP—Taxpayer.
TR—Trust.
TT—Trustee.
U.S.C.—United States Code.
X—Corporation.
Y—Corporation.
Z —Corporation.

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[1] A cumulative list of current actions on previously published items in Internal Revenue Bulletins 2012–27 through 2012–52 is in Internal Revenue Bulletin 2012–52, dated December 27, 2012.

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