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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.

ADMINISTRATIVE, EMPLOYMENT TAX, INCOME TAX

T.D. 9861, page 433.

This document contains final regulations that specify that employers may voluntarily truncate employees' social security numbers to appear as IRS truncated taxpayer identification numbers (TTINs) on copies of Forms W-2, Wage and Tax Statement, that are furnished to employees, consistent with the rules for truncation in Treas. Reg. 301.6109-4. The regulations also delete obsolete provisions and update cross-references in the existing regulations under sections 6051 and 6052.

EMPLOYEE PLANS

REG-121508-18, page 456.

This document sets forth proposed regulations relating to the tax qualification of plans maintained by more than one employer. These plans, maintained pursuant to section 413(c) of the Internal Revenue Code (Code), are often referred to as multiple employer plans or MEPs. The proposed regulations would provide an exception, if certain requirements are met, to the application of the "unified plan rule" for a defined contribution MEP in the event of a failure by an employer participating in the plan to satisfy a qualification requirement or to provide information needed to determine compliance with a qualification requirement. These proposed regulations would affect MEPs, participants in MEPs (and their beneficiaries), employers participating in MEPs, and MEP plan administrators.

EXCISE TAX, EXEMPT ORGANIZATIONS

REG-106877-18, page 441.

This document contains proposed regulations for determining the excise tax applicable to the net investment income of certain private colleges and universities, as provided by the Tax Cuts and Jobs Act. These regulations affect applicable educational institutions and their related organizations.

INCOME TAX

T.D. 9869, page 438.

The final regulations clarify that where a partnership is the owner of an entity that is disregarded as separate from its owner for any purpose under section 301.7701-2, the entity is not treated as a corporation for purposes of employing direct or indirect partners of the partnership that owns the entity, but instead the partners in the partnership are subject to the same self-employment rules as partners of a partnership that does not own an entity that is disregarded as an entity separate from its owner for any purpose under section 301.7701-2.

Finding Lists begin on page ii.

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.

T.D. 9861

DEPARTMENT OF THE TREASURY

Internal Revenue Service 26 CFR Parts 1, 31, and 301

Use of Truncated Taxpayer Identification Numbers on Forms W-2, Wage and Tax Statement, Furnished to Employees

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final rulemaking.

SUMMARY: This document contains final regulations under sections 6051 and 6052 of the Internal Revenue Code (Code). To aid employers' efforts to protect employees from identity theft, these regulations amend existing regulations to permit employers to voluntarily truncate employees' social security numbers (SSNs) on copies of Forms W-2, Wage and Tax Statement, that are furnished to employees so that the truncated SSNs appear in the form of IRS truncated taxpayer identification numbers (TTINs). These regulations also amend the regulations under section 6109 to clarify the application of the truncation rules to Forms W-2 and to add an example illustrating the application of these rules. Additionally, these regulations delete obsolete provisions and update cross references in the regulations under sections 6051 and 6052. These regulations affect employers who are required to furnish Forms W-2 and employees who receive Forms W-2.

DATES: *Effective Date*: These regulations are effective on July 3, 2019.

Applicability Date: For dates of applicability, see §§1.6052-2(d), 31.6051-1(k), 31.6051-2(d), 31.6051-3(f), 301.6109-4(c).

FOR FURTHER INFORMATION CONTACT: Concerning these regulations, Eliezer Mishory, (202) 317-6844 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background:

This document contains amendments to the Income Tax Regulations (26 CFR part 1), the Employment Taxes and Collection of Income Tax at Source Regulations (26 CFR part 31), and the Procedure and Administration Regulations (26 CFR part 301) regarding statements that are required to be furnished to employees by employers or other persons under sections 6051 and 6052 of the Code. On September 20, 2017, a notice of proposed rulemaking (REG-105004-16) was published in the **Federal Register** (82 FR 43920). The notice of proposed rulemaking proposed to permit employers to truncate employees' SSNs to appear in the form of TTINs on copies of Forms W-2 that are furnished to employees. In addition, the notice of proposed rulemaking proposed to amend the regulations under section 6109 to clarify the application of the truncation rules to Forms W-2 and to add an example illustrating the application of these rules. Finally, the notice of proposed rulemaking proposed to delete obsolete provisions and update cross references in the regulations under sections 6051 and 6052. The proposed regulations were proposed to apply to statements required to be filed and furnished under sections 6051 and 6052 after December 31, 2018.

The IRS received comments on the notice of proposed rulemaking, but no public hearing was requested or held. After consideration of the comments, this Treasury decision adopts the proposed regulations without substantive changes to the content of the rules. The applicability date provisions have been changed. The regulations will apply to returns, statements, and other documents required to be filed or furnished after December 31, 2020, except for §31.6051-2, as amended, which will apply as of the date of publication in the Federal Register. A detailed explanation of these regulations can be found in the preamble to the proposed rules. 82 FR 43920.

Summary of Comments

Seventeen written comments were submitted on the notice of proposed rulemaking. They are available at www.regulations.gov or upon request. Many of the comments recommended adopting the proposed rules. This preamble addresses the substantive comments that were critical of the proposed rules permitting employers to truncate employees' SSNs to appear in the form of TTINs on copies of Forms W-2 that are furnished to employees or requested clarification of the proposed rule.

Several commenters disagreed with the proposed rules. Commenters stated that not including a complete SSN on the copy of the Form W-2 will make it difficult for employees to verify that the SSN appearing on the copy of the employee's Form W-2 that is filed with the Social Security Administration (SSA) and the IRS is correct, will make it difficult for employees to identify and correct mistakes in lifetime earnings, will make it more difficult for tax return preparers to verify that the taxpayer has provided the correct SSN, may make it more difficult for employees to provide proof of income to lenders, and will confuse employees who receive multiple Forms W-2, some with truncated SSNs and others with complete SSNs.

The Department of the Treasury (Treasury Department) and the IRS did not adopt these comments. The commenters noted potential, unintended consequences of allowing SSNs to appear in the form of a TTIN on Forms W-2. The Treasury Department and the IRS have determined that the benefit of allowing employers to protect their employees from identity theft by truncating employees' SSNs to appear in the form of a TTIN outweighs the risk that the unintended consequences identified by the commenters will occur. Additionally, many of the potential consequences noted by the commenters can be mitigated.

First, tax return preparers can use Forms W-2 containing truncated SSNs to verify employee information by using the last four digits of the SSN and the employee's name and address. Second, preparers can use other documentation to verify employee information. For example, they can verify the accuracy of a taxpayer's SSN by requesting to see the taxpayer's social security card. Third, the only comment submitted regarding lender verification questioned whether verification would be more difficult, and the commenter did not represent having any expertise on the topic. No lender submitted comments suggesting the inclusion of a truncated SSN rather than a complete SSN would affect the lenders' ability to verify income using Forms W-2. If a lender refuses to accept a Form W-2 with a truncated SSN, employees may verify income by other methods, such as providing pay stubs. Fourth, there are many taxpayers who do not receive Forms W-2, and tax return preparers and lenders are able to verify the accuracy of these taxpayers' information. Methods used to verify information for taxpayers who do not receive a Form W-2 can be used to verify information for taxpayers who received a Form W-2 with a truncated SSN. Similarly, methods used by taxpayers who do not receive a Form W-2 to verify their earnings with SSA can be used by employees who receive Forms W-2 with a truncated SSN if there is an issue using the employees' Forms W-2. Finally, the instructions to Form W-2 will be updated to reflect these regulations and explain that truncation is not mandatory, which will reduce any potential for confusion for taxpayers receiving multiple Forms W-2.

Several comments addressed potential consequences if state governments do not also allow truncation. One commenter stated that even under the proposed rule, employees' identities would not be protected because state and local governments will not allow truncation. Another commenter stated that the proposed rules will cause confusion and could cause employees to violate state and local government rules if the state and local governments do not allow for truncation on copies filed with state and local governments. This commenter also stated that the proposed rules will increase the administrative burden on employers with employees who work in multiple states because the employer will have to determine the requirements for each state. Finally, one commenter stated that the proposed rules will make it more difficult for state authorities to process Forms W-2 and to determine if someone is using an SSN that is not his or hers.

The Treasury Department and the IRS have considered these comments and declined to adopt them. Truncation allows employers to actively assist their employees by safeguarding their employees' identities. The commenters speculate that state or local governments may prevent truncation on the copy of the Forms W-2 submitted to the state. That may be true, but other state and local governments may allow truncation. Truncation, and the identity protection benefits associated with truncation, should not be prohibited for all employees because some state and local governments may not allow truncation. The permissive nature of the rules accommodate the restrictions of individual states. Similarly, the rules accommodate potential burdens imposed on employers by making truncation optional. If employers with employees in multiple states find the process too burdensome, they may choose not to truncate. The Treasury Department and the IRS determined that there is a benefit in allowing for truncation because it will benefit the employees of employers who choose to take advantage of it after considering applicable state and local government rules.

Only one state submitted a comment on its ability to process Forms W-2 with truncated SSNs, and that comment supported the adoption of the proposed rules. At the request of several state tax administrators, the proposed rules provided that the applicable date would not be earlier than December 31, 2018, to give the states sufficient time to make necessary changes to their systems. The final regulations provide that these rules apply to returns, statements, and other documents required to be filed or furnished after December 31, 2020.

Finally, one commenter speculated that software vendors would not allow the option for truncated employee SSNs to appear as IRS TTINs. The Treasury Department and the IRS did not receive any comments from software vendors indicating that they could not or would not truncate SSNs on the Form W-2. Two payroll organizations submitted comments that supported the proposed rule. Further, because truncation is permissive and not mandatory, there is no negative consequence to the employer if a particular software vendor does not allow for truncation.

Commenters also suggested alternatives to the proposed rules. One commenter suggested that a better way to protect employees' identities would be to require employers to furnish employees' copies of Forms W-2 electronically. This comment was outside the scope of the proposed rule, and the Treasury Department and the IRS did not adopt this comment. Allowing truncation provides a different benefit to employees than electronic furnishing. Under existing rules, however, employers are allowed to furnish Forms W-2 electronically if the employee consents.

One commenter suggested that employers should be required to furnish one copy of Form W-2 to employees with the employees' full SSN. The Treasury Department and the IRS did not adopt this comment. As other commenters noted, including one copy of Form W-2 with the employee's full SSN along with the copies where the employee's SSN appears as an IRS TTIN defeats the purpose of permitting truncation.

One commenter stated that truncation should be mandatory. The Treasury Department and the IRS did not adopt this comment. As commenters noted, maintaining consistent rules regarding truncation reduces the compliance burden for filers. Under the generally applicable rules for truncation, truncation is permitted, not mandatory. The proposed rules permitting, but not requiring, truncation, conforms to the generally applicable rules for truncation in §301.6109-4. Amending those rules to make truncation mandatory for one particular form would be inconsistent with the general rules and would increase burden on filers. Additionally, as commenters noted, while truncation is an important element of protecting against identity theft, truncation may also have other consequences, both for employers and for employees. Therefore, the Treasury Department and the IRS determined that it should be left to the employers, who furnish the forms, to decide whether to truncate.

Commenters requested clarification regarding the scope of the rules permitting employers to truncate employees' SSNs to appear in the form of a TTIN on copies of Forms W-2 that are furnished to employees, and the forms to which the rules apply, including Forms W-2c, Forms 1099, Form 1095-C, and the territorial Forms W-2. These regulations permit employers to truncate employees' SSNs to appear in the form of a TTIN on copies of Forms W-2 that are furnished to employees under sections 6051(a) and (f)(2) and 6052(b). This includes Forms W-2c that are furnished to correct errors on Forms W-2 that are furnished under sections 6051(a) and (f)(2) and 6052(b). The regulations do not apply to any other forms.

In general, under the truncation rules in §301.6109-4(b)(2)(ii), a TTIN may not be used on a statement or document if a statute, regulation, other guidance published in the Internal Revenue Bulletin, form, or instructions, specifically requires use of an SSN, IRS individual taxpayer identification number (ITIN), IRS adoption taxpayer identification number (ATIN), or IRS employer identification number (EIN) and does not specifically permit truncation. If a specific form continues to require an SSN and does not permit truncation, the SSN may not be truncated to appear in the form of an IRS TTIN. The IRS intends to incorporate the revised regulations into forms and instructions, permitting employers to truncate employees' SSNs to appear in the form of an IRS TTIN on employees' copies of Forms W-2.

Only positive comments were received regarding the miscellaneous updates to regulations under sections 6051 and 6052, and these rules are also finalized as proposed.

Effective/applicability date

These regulations are effective on the date of publication in the **Federal Register**. These regulations amend the effective/applicability date provisions in §31.6051-1 and §31.6051-3, and add an applicability date provision to §1.6052-2. Sections 31.6051-1, 31.6051-3, and 1.6052-2, as amended, are applicable for statements required to be filed and furnished under sections 6051 and 6052 after December 31, 2020. These regulations add an applicability date provision to §31.6051-2. Section 31.6051-2, as amended, is applicable on the date of publication in the Federal Register. These regulations amend the effective/applicability date provision in §301.6109-4. Section 301.6109-4, as amended, is applicable to returns, statements, and other documents required to be filed or furnished after December 31, 2020.

Statement of Availability of IRS Documents

IRS Revenue Procedures, Revenue Rulings notices, and other guidance cited in this preamble are published in the Internal Revenue Bulletin (or Cumulative Bulletin) and are available from the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402, or by visiting the IRS website at www.irs.gov.

Special Analyses

These regulations are not subject to review under section 6(b) of Executive Order 12866 pursuant to the Memorandum of Agreement (April 11, 2018) between the Treasury Department and the Office of Management and Budget regarding review of tax regulations. Because these regulations do not impose a collection of information on small entities, a regulatory impact analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking that preceded these final regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business. No comments were received from the Small Business Administration.

Drafting Information

The principal author of these regulations is Eliezer Mishory of the Office of the Associate Chief Counsel (Procedure and Administration).

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Amendments to the Regulations

Accordingly, 26 CFR parts 1, 31 and 301 are amended as follows:

PART 1—INCOME TAXES

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

Authority: 26 U.S.C. 7805, unless otherwise noted.

* * * * *

Par. 2. Section 1.6052-2 is amended by:

1. Revising paragraph (a).
2. Removing paragraph (b).
3. Redesignating paragraph (e) as new paragraph (b).
4. Revising paragraphs (c) and (d).
5. Removing paragraphs (f) and (g).

The revisions read as follows:

§1.6052-2 Statements to be furnished to employees with respect to wages paid in the form of group-term life insurance.

(a) *Requirement*. Every employer filing a return under section 6052(a) and §1.6052-1, with respect to group-term life insurance on the life of an employee, shall furnish to the employee whose name is set forth in such return the tax return copy and the employee's copy of Form W-2. Each copy of Form W-2 must show the information required to be shown on the Form W-2 filed under §1.6052-1. An employer may truncate an employee's social security number to appear in the form of an IRS truncated taxpayer identification number (TTIN) on copies of Forms W-2 furnished to the employee. For provisions relating to the use of TTINs, see §301.6109-4 of this chapter (Procedure and Administration Regulations). The rules in §31.6051-1 of this chapter (Employment Taxes and Collection of Income Tax at Source Regulations) shall apply with respect to the means and time (including extensions thereof) for furnishing the employee's copy of Form W-2 required by this section to the employee and making corrections to such form.

* * * * *

(c) *Penalty*. For provisions relating to the penalty provided for failure to furnish a statement under this section, see section 6722 and the regulations in part 301 under section 6722.

(d) *Applicability date*. This section is applicable for statements required to be furnished under section 6052 after December 31, 2020.

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

Par. 3. The authority citation for part 31 is amended by adding an entry for §31.6051-3 in numerical order to read in part as follows:

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

Section 31.6051-3 also issued under 26 U.S.C. 6051.

* * * * *

Par. 4. Section 31.6051-1 is amended by:

1. Redesignating and moving the undesignated text after pargraph (a)(1)(i)(*f*) after the fourth sentence in paragraph (a)(1)(i).
2. Redesignating paragraphs (a)(1)(i)(*a*) through (*h*) as (a)(1)(i)(A) through (H), respectively.
3. Revising newly redesignated paragraphs (a)(1)(i)(B) and (b)(1)(ii).
4. Removing paragraph (d)(1)(ii)(C).
5. Revising paragraphs (f), (h)(2), and (i).
6. Removing paragraph (j)(8).
7. Adding paragraph (k).

The revisions and addition read as follows:

§31.6051-1 Statements for employees.

(a) * * *

(1) * * *

(i) * * *

(B) The name, address, and social security number of the employee, which may be truncated to appear in the form of an IRS truncated taxpayer identification number (TTIN) on copies of Forms W-2 that are furnished to the employee (for provisions relating to the use of TTINs, see §301.6109-4 of this chapter (Procedure and Administration Regulations)), if wages as defined in section 3121(a) have been paid or if the Form W-2 is required to be furnished to the employee,

* * * * *

(b) * * *

(1) * * *

(ii) The name, address, and social security number of the employee, which may be truncated to appear in the form of a TTIN on copies of Forms W-2 that are furnished to the employee (for provisions relating to the use of TTINs, see §301.6109-4 of this chapter),

* * * * *

(f) *Statements with respect to compensation, as defined in the Railroad Retirement Tax Act*—(1) *Notification of possible credit or refund*. With respect to compensation (as defined in section 3231(e)), every employer (as defined in section 3231(a)) who is required to deduct and withhold from an employee (as defined in section 3231(b)) a tax under section 3201, shall include on or with the statement required to be furnished to such employee under section 6051(a), a notice concerning the provisions of this title with respect to the allowance of a credit or refund of the tax on wages imposed by section 3101(b) and the tax on compensation imposed by section 3201 or 3211, which is treated as a tax on wages imposed by section 3101(b).

(2) *Information to be supplied to employees upon request*. With respect to compensation (as defined in section 3231(e)), every employer (as defined in section 3231(a)) who is required to deduct and withhold tax under section 3201 from an employee (as defined in section 3231(b)) who has also received wages during such year subject to the tax imposed by section 3101(b), shall upon request of such employee furnish to him or her a written statement showing—

(i) The total amount of compensation with respect to which the tax imposed by section 3101(b) was deducted;

(ii) The total amount of employee tax under section 3201 deducted and withheld (increased by any adjustment in the calendar year for overcollection, or decreased by any adjustment in such year for undercollection, of such tax during any prior year); and

(iii) The proportion thereof (expressed either as a dollar amount, or a percentage of the total amount of compensation as defined in section 3231(e), or as a percentage of the total amount of employee tax under section 3201) withheld as tax under section 3201 for financing the cost of hospital insurance benefits.

(h) * * *

(2) *Time for furnishing statement*. The statement required by this paragraph (h) for a calendar year shall be furnished—

(i) In the case of an employee who is required to be furnished a Form W-2, Wage and Tax Statement, for the calendar year, within one week of (before or after) the date that the employee is furnished a timely Form W-2 for the calendar year (or, if a Form W-2 is not so furnished, on or before the date by which it is required to be furnished); and

(ii) In the case of an employee who is not required to be furnished a Form W-2 for the calendar year, on or before February 7 of the year succeeding the calendar year.

* * * * *

(i) *Cross references*. For provisions relating to the penalties provided for the willful furnishing of a false or fraudulent statement, or for the willful failure to furnish a statement, see §31.6674-1 and section 7204. For additional provisions relating to the inclusion of identification numbers and account numbers in statements on Form W-2, see §§31.6109-1 and 31.6109-4. For the penalties applicable to information returns and payee statements, see sections 6721 through 6724 and the regulations in part 301 under sections 6721 through 6724.

* * * * *

(k) *Applicability date*. This section is applicable for statements required to be furnished under section 6051 after December 31, 2020.

Par. 5. Section 31.6051-2 is amended by revising paragraphs (a) and (c) and adding paragraph (d) to read as follows:

§31.6051-2 Information returns on Form W-3 and Social Security Administration copies of Forms W-2.

(a) *In general*. Every employer who is required to make a return of tax under §31.6011(a)-1 (relating to returns under the Federal Insurance Contributions Act), §31.6011(a)-4 (relating to returns of income tax withheld from wages), or §31.6011(a)-5 (relating to monthly returns) for a calendar year or any period therein, shall file the Social Security Administration copy of each Form W-2 required under §31.6051-1 to be furnished by the employer with respect to wages paid during the calendar year. An employer may not truncate an employee's social security number to appear in the form of an IRS truncated taxpayer identification number (TTIN) on copies of Forms W-2 filed with the Social Security Administration. Each Form W-2 and the transmittal Form W-3 shall together constitute an information return to be filed with the Social Security Administration as indicated on the instructions to such forms. For the requirement to submit the information on Form W-2 on magnetic media, see section 6011(e) and §301.6011-2 of this chapter (Procedure and Administration Regulations).

* * * * *

(c) *Cross references*. For provisions relating to the time for filing the information returns required by this section and to extensions of the time for filing, see sections 6071 and 6081 and the regulations in this part under sections 6071 and 6081. For the penalties applicable to information returns and payee statements, see sections 6721 through 6724 and the regulations in part 301 under sections 6721 through 6724.

(d) *Applicability date*. This section is applicable for statements required to be filed under section 6051 after July 3, 2019.

Par. 6. Section 31.6051-3 is amended by revising paragraphs (a)(1)(i), (b)(1), (e)(3), and (f) and removing paragraph (g) to read as follows:

§31.6051-3 Statements required in case of sick pay paid by third parties.

(a) * * *

(1) * * *

(i) The name and, if there is withholding from sick pay under section 3402(o) and the regulations in this part under section 3402(o), the social security account number of the payee (the payee's social security number may not be truncated to appear in the form of an IRS truncated taxpayer identification number (TTIN)),

(b) * * *

(1) All of the information required to be furnished under paragraph (a) of this section, but the employer may truncate the payee's social security number to appear in the form of a TTIN on copies of Forms W-2 that are furnished to the payee (for provisions relating to the use of TTINs, see §301.6109-4 of this chapter (Procedure and Administration Regulations)).

* * * * *

(e) * * *

(3) The provisions of section 6109 (relating to identifying numbers) and the regulations in this part and part 301 under section 6109 shall be applicable to Form W-2 and to any payee of sick pay to whom a statement on Form W-2 is required by this section to be furnished. The employer must include the social security number of the payee on all copies of Forms W-2. The employer may truncate the payee's social security number to appear in the form of a TTIN on copies of Forms W-2 that are furnished to the payee. For provisions relating to the use of TTINs, see §301.6109-4 of this chapter.

(f) *Applicability date*. This section is applicable for statements required to be furnished under section 6051 after December 31, 2020.

PART 301 - PROCEDURE AND ADMINISTRATION

Par. 7. The authority citation for part 301 continues to read in part as follows:

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

Par. 8. Section 301.6109-4 is amended by revising paragraphs (b)(2)(ii) and (iii), (b)(3), and (c) to read as follows:

§301.6109-4 IRS truncated taxpayer identification numbers.

* * * * *

(b) * * *

(2) * * *

(ii) A TTIN may not be used on a statement or document if a statute, regulation, other guidance published in the Internal Revenue Bulletin, form, or instructions, specifically requires use of an SSN, ITIN, ATIN, or EIN and does not specifically state that the taxpayer identifying number may be truncated. For example, a TTIN may not be used on a Form W-8ECI or Form W-8IMY because the forms and/or form instructions specifically prescribe use of an SSN, EIN, or ITIN for the U.S. taxpayer identification number.

(iii) A TTIN may not be used on any return, statement, or other document that is required to be filed with or furnished to the Internal Revenue Service or the Social Security Administration in the case of forms required to be filed with the Social Security Administration under the internal revenue laws.

* * * * *

(3) *Examples*. The provisions of this paragraph (b) are illustrated by the following examples:

(i) *Example 1*. Pursuant to section 6051(d) and §31.6051-2(a) of this chapter, Employer files the Social Security Administration copy of Employee's Form W-2, Wage and Tax Statement, with the Social Security Administration. Employer may not truncate any identifying number on the Social Security Administration copy. Pursuant to section 6051(a) and §31.6051-1(a)(1)(i) of this chapter, Employer furnishes copies of Forms W-2 to Employee. There are no applicable statutes, regulations, other published guidance, forms, or instructions that prohibit use of a TTIN on Form W-2, and §31.6051-1(a)(1)(i) specifically permits truncating employees' SSNs. Accordingly, Employer may truncate Employee's SSN to appear in the form of a TTIN on copies of Forms W-2 furnished to Employee. Employer may not truncate its own EIN on copies of Forms W-2 furnished to Employee.

(ii) *Example 2*. On April 5, year 1, Donor contributes a used car with a blue book value of $1,100 to Charitable Organization. On April 20, year 1, Charitable Organization sends Donor copies B and C of the Form 1098-C as a contemporaneous written acknowledgement of the $1,100 contribution as required by section 170(f)(12). In late-February, year 2, Charitable Organization prepares and files copy A of Form 1098-C with the IRS, reporting Donor's donation of a qualified vehicle in year 1. Charitable Organization may truncate Donor's SSN to appear in the form of a TTIN in the Donor's Identification Number box on copies B and C of the Form 1098-C because copies B and C of the Form 1098-C are documents required by the Internal Revenue Code and regulations to be furnished to another person; there are no applicable statutes, regulations, other published guidance, forms or instructions that prohibit the use of a TTIN on those copies; and there are no applicable statutes, regulations, other published guidance, forms, or instructions that specifically require use of an SSN or other identifying number on those copies. Charitable Organization may not truncate its own EIN on copies B and C of the Form 1098-C because a person cannot truncate its own taxpayer identifying number on any statement or other document the person furnishes to another person. Charitable Organization may not truncate any identifying number on copy A of the Form 1098-C because copy A is required to be filed with the IRS.

(c) *Applicability date*. This section is applicable to returns, statements, and other documents required to be filed or furnished after December 31, 2020.

Kirsten Wielobob,
Deputy Commissioner for Services and Enforcement.

Approved: May 2, 2019.

David J. Kautter,
Assistant Secretary for Tax Policy.

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T.D. 9869

DEPARTMENT OF THE TREASURY

Internal Revenue Service 26 CFR Part 301

Self-employment Tax Treatment of Partners in a Partnership that Owns a Disregarded Entity

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulation.

SUMMARY: This document contains final regulations that clarify the employment tax treatment of partners in a partnership that owns a disregarded entity. These regulations affect partners in a partnership that owns a disregarded entity.

DATES: *Effective date*: These regulations are effective on July 2, 2019.

Applicability date: For dates of applicability, see §301.7701-2(e)(8).

FOR FUTHER INFORMATION CONTACT: Andrew K. Holubeck at (202) 317-4774 or Danchai Mekadenaumporn at (202) 317-6798 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document contains amendments to 26 CFR part 301. Section 301.7701-2(c)(2)(i) of the regulations specifies that, except as otherwise provided, a business entity that has a single owner and is not a corporation under §301.7701-2(b) is disregarded as an entity separate from its owner (a disregarded entity). However, §301.7701-2(c)(2)(iv)(B) treats a disregarded entity as a corporation for purposes of employment taxes imposed under Subtitle C of the Internal Revenue Code (Code). This exception to the treatment of disregarded entities does not apply to taxes imposed under Subtitle A of the Code, including self-employment taxes, and the regulations issued in TD 9670 on June 26, 2014 (79 FR 36204) explicitly provided that the owner of a disregarded entity who is treated as a sole proprietor for income tax purposes is subject to self-employment taxes.

On May 4, 2016, temporary regulations (TD 9766) clarifying the employment tax treatment of partners in a partnership that owns a disregarded entity were published in the **Federal Register** (81 FR 26693, as corrected July 5, 2016, at 81 FR 43488). Prior to the publication of the temporary regulations, the regulations did not explicitly address situations in which the owner of a disregarded entity is a partnership, and the Department of the Treasury (Treasury Department) and the IRS had been informed that some taxpayers were reading the regulations to permit the treatment of the individual partners in a partnership that owned a disregarded entity (either directly or through tiered partnerships) as employees of the disregarded entity. The Treasury Department and the IRS issued the temporary regulations to clarify that the rule that a disregarded entity is treated as a corporation for employment tax purposes does not apply to the self-employment tax treatment of any individuals who are partners in a partnership that owns a disregarded entity. The temporary regulations, like the final regulations they replaced, continued to explicitly provide that the owner of a disregarded entity who is treated as a sole proprietor for income tax purposes is subject to self-employment taxes. A notice of proposed rulemaking (REG-114307-15) cross-referencing the temporary regulations was published in the **Federal Register** on the same day (81 FR 26763). No public hearing was requested or held. Comments responding to the notice of proposed rulemaking were received. All comments were considered and are available for public inspection and copying at *http://www.regulations.gov* or upon request. After consideration of all the comments, the proposed regulations are adopted as amended by this Treasury decision, and the corresponding temporary regulations are removed. The public comments are discussed in this preamble.

Explanation and Summary of Comments

The Treasury Department and the IRS received two comments in response to the proposed regulations. One commenter requested that the Treasury Department and the IRS consider addressing whether an eligible entity's election to be classified as an association (and thus a corporation under §301.7701–2(b)(2)) pursuant to the final entity classification regulations under section 7701 of the Code (also known as the "Check-the-Box" regulations) would change the result such that a partner of the upper tier entity could be an employee at the lower tier entity that is treated as a corporation. While the temporary regulations did not address tiered entities, the use of an entity classified as a corporation under the Check-the-Box regulations presents different issues, such as whether, under the facts and circumstances, the partner is an employee of the corporation. However, these issues are outside the scope of these final regulations, and for this reason, these regulations do not address this comment.

In the preamble of TD 9766, the Treasury Department and the IRS requested comments on the appropriate application of the principles of Rev. Rul. 69-184, 1969-1 C.B. 256, to tiered partnership situations, the circumstances in which it may be appropriate to permit partners to also be employees of the partnership, and the impact on employee benefit plans (including, but not limited to, qualified retirement plans, health and welfare plans, and fringe benefit plans) and on employment taxes if Rev. Rul. 69-184 were to be modified to permit partners to also be employees in certain circumstances.

In response to this request, one commenter described the effects of the application of the principles of Rev. Rul. 69-184 in the context of publicly traded partnerships. This commenter noted that one particular concern in the publicly traded partnership context is that the publicly traded partnership may not know which service providers treated as employees (whether at the publicly traded partnership level or at any disregarded entity owned by the publicly traded partnership) hold units since individuals may purchase units on the open market without the knowledge of the publicly traded partnership. If an acquisition of units by the service provider occurs without the publicly traded partnership's knowledge, then improper tax withholding and benefit plan participation may occur until the publicly traded partnership discovers the error. This commenter also noted a number of negative effects on service providers receiving equity-based compensation from a publicly traded partnership and the ensuing burden required in administering any equity-based compensation plan in the publicly traded partnership context. This commenter requested that the IRS consider an exception to the principles of Rev. Rul. 69-184 for publicly traded partnerships.

As noted in the preamble to TD 9766, these regulations do not address the application of Rev. Rul. 69-184 in tiered partnership situations, but rather clarify that a disregarded entity owned by a partnership is not treated as a corporation for purposes of employing any partner of the partnership. Similarly, these regulations also do not address the application of Rev. Rul. 69-184 to publicly traded partnerships. Accordingly, the final regulations do not provide an exception to the principles of Rev. Rul. 69-184 for publicly traded partnerships. However, the Treasury Department and the IRS will continue to consider the application of Rev. Rul. 69-184, including the specific issue noted by the commenter, and welcome further comments.

The temporary regulations provided that their applicability date would be the later of August 1, 2016, or the first day of the latest-starting plan year following May 4, 2016 of an affected plan (based on the plans adopted before, and the plan years in effect as of, May 4, 2016) sponsored by an entity that is disregarded as an entity separate from its owner for any purpose under §301.7701-2. It has come to the attention of the Treasury Department and the IRS that some taxpayers may have read the applicability date to begin on the first day of the last plan year prior to the termination of an affected plan (as defined in §301.7701-2(e)(8)), which may have been a date after May 4, 2017 . This is not a proper reading of the applicability date.

In the case of an entity with several affected plans that may have different plan years, the applicability date was the first day of the plan year of the affected plan that had the latest plan year beginning after May 4, 2016, and on or before May 4, 2017 (assuming that date is after August 1, 2016). For example, an entity may have had two affected plans, with one plan year that began on September 1, 2016, and another plan year that began on January 1, 2017. In this case, the applicability date for this entity would have been January 1, 2017. The applicability date for any entity affected by these regulations should not have been delayed beyond May 4, 2017 in any case. For this reason, the final regulations clarify in §301.7701-2(e)(8) that the applicability date of §301.7701-2(c)(2)(iv)(C)(*2*) is the later of August 1, 2016, or the first day of the latest-starting plan year beginning after May 4, 2016, and on or before May 4, 2017, of an affected plan (based on the plans adopted before, and the plan years in effect as of, May 4, 2016) sponsored by an entity that is disregarded as an entity separate from its owner for any purpose under §301.7701-2.

Special Analysis

This regulation is not subject to review under section 6(b) of Executive Order 12866 pursuant to the Memorandum of Agreement (April 11, 2018) between the Department of the Treasury and the Office of Management and Budget regarding review of tax regulations. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, the NPRM preceding this regulation was 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 Andrew Holubeck of the Office of the Associate Chief Counsel (Employee Benefits, Exempt Organizations and Employment Taxes). However, other personnel from the IRS and the Treasury Department participated in their development.

Statement of Availability

IRS Revenue Procedures, Revenue Rulings, Notices, and other guidance cited in this document are published in the Internal Revenue Bulletin (or Cumulative Bulletin) and are available from the Superintendent of Documents, U.S. Government Publishing Office, Washington, DC 20402, or by visiting the IRS website at *http://www.irs.gov*.

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Amendments to the Regulations

Accordingly, 26 CFR part 301 is amended as follows:

PART 301—PROCEDURE AND ADMINISTRATION

Paragraph 1. The authority citation for part 301 continues to read in part as follows:

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

Par. 2. Section 301.7701-2 is amended by:

1. Revising paragraph (c)(2)(iv)(C)(*2*).
2. Removing the "(e)" from the "(e)(8)" paragraph designation and revising paragraph (e)(8).

The revisions read as follows:

§301.7701-2 Business entities; definitions.

* * * * *

(c) * * *

(2) * * *

(iv) * * *

(C) * * *

(*2*) Paragraph (c)(2)(i) of this section applies to taxes imposed under subtitle A of the Code, including Chapter 2—Tax on Self-Employment Income. Thus, an entity that is treated in the same manner as a sole proprietorship under paragraph (a) of this section is not treated as a corporation for purposes of employing its owner; instead, the entity is disregarded as an entity separate from its owner for this purpose and is not the employer of its owner. The owner will be subject to self-employment tax on self-employment income with respect to the entity's activities. Also, if a partnership is the owner of an entity that is disregarded as an entity separate from its owner for any purpose under this section, the entity is not treated as a corporation for purposes of employing a partner of the partnership that owns the entity; instead, the entity is disregarded as an entity separate from the partnership for this purpose and is not the employer of any partner of the partnership that owns the entity. A partner of a partnership that owns an entity that is disregarded as an entity separate from its owner for any purpose under this section is subject to the same self-employment tax rules as a partner of a partnership that does not own an entity that is disregarded as an entity separate from its owner for any purpose under this section.

* * * * *

(e) ***

(8) Paragraph (c)(2)(iv)(C)(*2*) of this section applies on the later of–

(i) August 1, 2016; or

(ii) The first day of the latest-starting plan year beginning after May 4, 2016, and on or before May 4, 2017, of an affected plan (based on the plans adopted before, and the plan years in effect as of, May 4, 2016) sponsored by an entity that is disregarded as an entity separate from its owner for any purpose under this section. For rules that apply before the applicability date of paragraph (c)(2)(iv)(C)(*2*) of this section, see 26 CFR part 301 revised as of April 1, 2016. For the purposes of this paragraph (e)(8)—

(A) An affected plan includes any qualified plan, health plan, or section 125 cafeteria plan if the plan benefits participants whose employment status is affected by paragraph (c)(2)(iv)(C)(*2*) of this section;

(B) A qualified plan means a plan, contract, pension, or trust described in paragraph (A) or (B) of section 219(g)(5) (other than paragraph (A)(iii)); and

(C) A health plan means an arrangement described under §1.105-5 of this chapter.

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§301.7701-2T [Removed]

Par. 3. Section 301.7701-2T is removed.

Kirsten Wielobob,
Deputy Commissioner for Services and Enforcement.

Approved: May 15, 2019.

David J Kautter,
Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on June 28, 2019 at 4:15 p.m. and published in the issue of the Federal Register for July 2, 2019, 84 F.R. 31478)

Part IV.

Guidance on the Determination of the Section 4968 Excise Tax Applicable to Certain Private Colleges and Universities

REG-106877-18

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations for determining the excise tax applicable to the net investment income of certain private colleges and universities, as provided by the Tax Cuts and Jobs Act. These regulations affect applicable educational institutions and their related organizations.

DATES: Written or electronic comments and requests for a public hearing must be received by October 1, 2019.

ADDRESSES: Submit electronic submissions via the Federal eRulemaking Portal at *http://www.regulations.gov* (indicate IRS and REG-106877-18) by following the online instructions for submitting comments. Once submitted to the Federal eRulemaking Portal, comments cannot be edited or withdrawn. The Department of the Treasury (Treasury Department) and the IRS will publish for public availability any comment received to its public docket, whether submitted electronically or in hard copy. Send hard copy submissions to: CC:PA:LPD:PR (REG-106877-18), Room 5203, 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-106877-18), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW, Washington, DC 20224.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Melinda Williams at (202) 317-6172 or Amber L. MacKenzie at (202) 317-4086; concerning submission of comments and request for hearing, Regina L. Johnson at (202) 317-6901 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed regulations under section 4968 of the Internal Revenue Code (Code) to amend part 53 of the Excise Tax Regulations (26 CFR part 53). Section 4968 of the Code, added by section 13701 of the Tax Cuts and Jobs Act, Public Law 115-97, 131 Stat. 2054, 2167-68, (2017) (TCJA), imposes on each applicable educational institution, as defined in section 4968(b)(1), an excise tax equal to 1.4 percent of the institution's net investment income, and, as described in section 4968(d), a portion of certain net investment income of certain related organizations, for the taxable year.

Section 4968(b)(1) defines the term "applicable educational institution" as an eligible educational institution (as defined in section 25A(f)(2)) which during the preceding taxable year had at least 500 tuition-paying students, more than 50 percent of whom were located in the United States, is not a state college or university as described in the first sentence of section 511(a)(2)(B), and had assets (other than those assets used directly in carrying out the institution's exempt purpose) the aggregate fair market value of which was at least $500,000 per student of the institution.

Section 4968(b)(2) provides that, for purposes of section 4968(b)(1), the number of students of an institution (including for purposes of determining the number of students at a particular location) shall be based on the daily average number of full-time students attending such institution (with part-time students taken into account on a full-time student equivalent basis).

Section 4968(c) provides that, for purposes of section 4968, "net investment income" shall be determined under rules similar to the rules of section 4940(c).

Section 4968(d)(1) provides that, for purposes of determining aggregate fair market value of an educational institution's assets not used directly in carrying out its exempt purpose[1] and for purposes of determining an institution's net investment income, the assets and net investment income of any related organization with respect to the institution shall be treated as assets and net investment income, respectively, of the educational institution, with two exceptions. First, no such amount shall be taken into account with respect to more than one educational institution. Second, unless such organization is controlled by such institution or is described in section 509(a)(3) (relating to supporting organizations) with respect to such institution for the taxable year, assets and net investment income which are not intended or available for the use or benefit of the educational institution shall not be taken into account.

Section 4968(d)(2) provides that the term "related organization," with respect to an educational institution, means (1) any organization which controls, or is controlled by, such institution; (2) is controlled by one or more persons that also control such institution; or (3) is a supported organization (as defined in section 509(f)(3)), or a supporting organization (as described in section 509(a)(3)), during the taxable year with respect to the educational institution.

The Conference Report for the TCJA, H. Rept. 115-466, 115th Cong., 1st sess., December 15, 2017 (Conference Report), at 555, states that Congress intended that the Secretary of the Treasury promulgate

[1] Section 4968(d)(1) erroneously cross references section 4968(b)(1)(C). The correct cross reference should be to section 4968(b)(1)(D). See Joint Committee on Taxation, "General Explanation of Public Law No. 115-97" (JCS-1-18), December 2018, at 290, n. 1357.

regulations to carry out the intent of section 4968, including regulations that describe: (1) Assets that are used directly in carrying out an educational institution's exempt purpose; (2) the computation of net investment income; and (3) assets that are intended or available for the use or benefit of an educational institution.

In June 2018, the Treasury Department and the IRS issued Notice 2018-55 (2018-26 I.R.B. 773) (Notice) to provide interim guidance on certain issues related to the application of the tax imposed by section 4968. Specifically, Notice 2018-55 states that, in the case of property held on December 31, 2017, and continuously thereafter to the date of its disposition, the Treasury Department and the IRS intend to propose regulations stating that basis for purposes of determining gain (but not loss) shall be deemed to be not less than the fair market value of such property on December 31, 2017, plus or minus all adjustments after December 31, 2017, and before the date of disposition consistent with the regulations under section 4940(c). The Notice provides that, if the disposition of an asset would result in a capital loss, basis rules that are consistent with the regulations under section 4940(c) will apply. Accordingly, if the value of the asset declines after December 31, 2017, the taxpayer will recognize no gain; however, the taxpayer will recognize a loss only if the proceeds from the sale of the asset are less than the basis of the property as calculated without the special rule in the Notice to increase the basis to fair market value on December 31, 2017. The Notice additionally states that the Treasury Department and the IRS expect the proposed regulations to provide that losses from sales or other dispositions of property generally shall be allowed only to the extent of gains, with no capital loss carryovers or carrybacks, and that losses from sales or other dispositions of property by related organizations will be allowed to offset overall net gains from other related organizations or the applicable educational institution. The Notice provides that applicable educational institutions may rely on the Notice before the issuance of the proposed regulations. Finally, the Notice requests comments on any of the issues addressed in the Notice and on any additional guidance that is needed and whether, and what type of, transitional relief may be necessary.

The Treasury Department and the IRS received two comments in response to Notice 2018-55, which were considered in drafting these proposed regulations. The comments are available at *http://www.regulations.gov* or upon request.

Explanation of Provisions

1. Institutions Subject to the Tax

Section 4968(a) imposes a 1.4 percent excise tax on the net investment income of each applicable educational institution. Section 4968(b) provides that an applicable educational institution is an "eligible educational institution" (as defined in section 25A(f)(2)) if: (i) it had at least 500 tuition-paying students during the preceding taxable year; (ii) more than 50 percent of its tuition-paying students are located in the United States; (iii) it is not a state college or university as described in the first sentence of section 511(a)(2)(B); and (iv) the aggregate fair market value of its assets (other than those assets used directly in carrying out the institution's exempt purpose) was at least $500,000 per student of the institution at the end of the preceding taxable year. Section 53.4968-1(a) of these proposed regulations sets forth definitions to determine whether an entity is an applicable educational institution that is subject to the tax.

Although, pursuant to section 4968(a), the tax on net investment income for each taxable year is based on the net investment income of an applicable educational institution for such taxable year, for purposes of determining whether an institution is an "applicable educational institution" subject to the tax, section 4968(b) provides that the number of an institution's tuition-paying students and the aggregate fair market value of the institution's assets (and the assets of any related organization) are based on the preceding taxable year's number and value.

A. Eligible Educational Institution Defined in Section 25A(f)(2)

Section 4968(b)(1) defines "applicable educational institution," in part, as an eligible educational institution defined in section 25A(f)(2). In accordance with section 4968(b), the proposed regulations provide that an applicable educational institution must be described in section 25A(f)(2) and the regulations thereunder. Section 25A(f)(2) provides that, for purposes of the allowance of American Opportunity and Lifetime Learning credits, the term "eligible educational institution" means an institution (1) which is described in section 481 of the Higher Education Act of 1965 (20 U.S.C. 1088) (HEA), as in effect on the enactment of section 25A (1997), and (2) which is eligible to participate in a program under title IV of the HEA (relating to the United States federal student financial aid programs). The Treasury Department and the IRS anticipate that colleges and universities already know whether they are described in section 25A, but request comments on whether further guidance is needed for purposes of applying section 4968.

B. Student

i. In General

Section 4968(b)(1) defines "applicable educational institution," in part, by reference to the number of its students and the amount of its assets per student. Section 4968 does not define the term "student." However, section 4968(b)(2) does provide that the number of students of an institution shall be based on the daily average number of full-time students attending an institution, with part-time students taken into account on a full-time student equivalent basis. As described in part 1(A) of this Explanation of Provisions section, the definition of the term "applicable educational institution" in section 4968(b), which references students in some of its definitional criteria, relies on the definition of "eligible educational institution" as defined in section 25A(f)(2).

For purposes of section 25A, the term "eligible student" is defined in section 25A(b)(3) to mean a student who (1) meets the requirements of section 484(a)(1) of the HEA (20 U.S.C. 1091(a)(1)), and (2) is carrying at least half the normal full-time work load for the course of study the student is pursuing. Section 484(a)(1) of the HEA (20 U.S.C. 1091(a)(1)) provides that, in order to receive any grant, loan, or work assistance under the general provisions relating to student assistance programs under the HEA, a student must be enrolled or accepted for enrollment in a degree, certification, or other program (including a program of study abroad approved for credit by the eligible institution at which such student is enrolled) leading to a recognized educational credential at an institution of higher education that is an eligible institution in accordance with the provisions of section 1094 of title 20 of the U.S. Code, except as provided in section 1091(b)(3) and (4) of the HEA,[2] and not enrolled in an elementary or secondary school.

The Treasury Department and the IRS consider the definition of eligible student under section 25A to be an appropriate basis for the definition of student for purposes of section 4968; however, the requirement found in section 25A(b)(3)(B) that a student must carry at least half the normal full-time work load for the course of study the student is pursuing is not relevant for purposes of section 4968. Section 4968(b)(2) does not contain a requirement that a student must carry at least half the normal full-time work load to be considered a student for purposes of the asset measurement requirement; instead, it states that part-time students are taken into account on a full-time student equivalent basis.

Furthermore, section 4968(b)(2) contains a requirement that the number of students of an institution be based on the daily average number of students attending the institution. Therefore, the Treasury Department and the IRS do not view the portion of the rule found in Section 484(a)(1) of the HEA that is incorporated into the definition of "student" in section 25A(b)(3)(B) and includes an individual merely "accepted for enrollment" as appropriate to the application of section 4968 since such an individual may not yet be attending the institution.

Accordingly, the proposed regulations generally follow the standard in section 484(a)(1) of the HEA referenced by section 25A(b)(3)(A) to provide that the term "student" for section 4968 purposes means a person enrolled in a degree, certification, or other program (including a program of study abroad approved for credit by the eligible institution at which such student is enrolled) leading to a recognized educational credential at an eligible educational institution, and not enrolled in an elementary or secondary school. See proposed §53.4968-1(a)(3)(i). However, the proposed definition of student does not include individuals merely accepted for enrollment, nor does it contain a requirement that the student have at least half the normal full-time work load. Furthermore, the time limitations in section 25A(b)(2) (such as that the American Opportunity Tax Credit is allowed only for 4 taxable years) are not part of the definition of "eligible student" and thus are not incorporated into the definition of student for section 4968 purposes.

Putting together the section 4968(b)(2) requirement that a student be "attending" an institution and the proposed definition that a student is an individual enrolled in a degree, certification, or other program leading to a recognized educational credential at an eligible educational institution, in applying the requirements under section 4968(b)(1), the proposed regulations require that a student be both enrolled at and attending the institution. The Treasury Department and the IRS request comments on whether further guidance is needed on the definitions of "student," "enrolled," or "attending."

Consistent with section 4968(b)(1)(D), the proposed regulations provide that an educational institution determines the fair market value of assets per student based upon the total number of all students, as defined in proposed §53.4968-1(a)(3)(i), attending an eligible educational institution, not just the number of tuition-paying students.

ii. Tuition-paying

Section 4968(b)(1) defines "applicable educational institution," in part, with respect to how many tuition-paying students attend the institution. Specifically, under section 4968(b)(1)(A) an institution must have had at least 500 tuition-paying students during the preceding taxable year, and under 4968(b)(1)(B), more than 50 percent of its tuition-paying students must have been located in the United States. Section 4968 does not define the term "tuition-paying."

As described in part 1(A) of this Explanation of Provisions section, section 25A provides certain education credits relating to qualified tuition and related expenses paid by certain eligible students. Section 25A(f)(1) and §1.25A-2(d) provide, in relevant part, that the term "qualified tuition and related expenses" means tuition and fees required for the enrollment or attendance at an eligible educational institution for courses of instruction at such institution. Such term does not include expenses with respect to any course or other education involving sports, games, or hobbies, unless such course or other education is part of the individual's degree program.

The Treasury Department and the IRS propose to base the definition of "tuition-paying" for purposes of section 4968 on the definition of qualified tuition and related expenses that is provided in section 25A(f)(1) and the regulations thereunder, without regard to section 25A(f)(1)(D). Thus, the proposed regulations provide that tuition-paying means the payment of tuition and fees required for the enrollment or attendance of a student for courses of instruction at an eligible educational institution but does not include any separate payment for supplies or equipment required during a specific course once a student is enrolled in and attending the course (for example, art supplies). Tuition-paying also does not include payment of room and board or other personal living expenses, and if a student is required to pay a fee (such as a comprehensive fee or a bundled fee) to an eligible educational institution that combines charges for tuition with charges for personal expenses such as room and board, then the student is a tuition-paying student. The Treasury Department and the IRS note that, notwithstanding the reference to "enrollment" for purposes of identifying tuition and fees, the tuition-paying student must also be attending the educational institu-

[2] Subsections (b)(3) and (4) of 20 U.S.C. 1091 provide exceptions to section 484(a)(1) of the HEA that allows students to be eligible for certain grant programs even if the student does not qualify under section 484(a)(1). Under the exceptions, the student must be carrying at least one-half the normal full-time work load for the course of study that the student is pursuing, as determined by an eligible institution, and be enrolled in a course of study necessary for enrollment in a program leading to a degree, certificate, professional credential or certification from a State that is required for employment as a teacher in an elementary or secondary school in that State.

tion for purposes of determining if there are at least 500 tuition-paying students.

For purposes of section 4968, the proposed regulations also provide that whether a student is "tuition-paying" is determined after taking into account any scholarships provided directly by the educational institution and any work study programs operated directly by the educational institution. However, scholarship payments provided by third parties, even if administered by the institution, are considered payments of tuition on behalf of the student. Accordingly, a student will be considered a tuition-paying student for purposes of section 4968 if payment of any tuition or a fee is required for the enrollment or attendance of the student for courses of instruction after the application of any scholarships offered directly by the institution or work study program operated directly by the institution.

iii. Located in the United States

Section 4968(b)(1)(B) provides, in part, that at least 50 percent of an applicable educational institution's tuition-paying students attending the institution must have been located in the United States. The statute clearly refers to the location of the students, not the location of the educational institution or an instructor. Accordingly, the proposed regulations provide that a student is considered to have been located in the United States if the student resided in the United States for at least a portion of the time the student attended the educational institution. Like the other requirements of section 4968(b), this measurement is based on the applicable educational institution's preceding taxable year.

For example, a student that attended an educational institution in the preceding taxable year who is citizen of a foreign country is considered to have been a student located in the United States if the student resided in the United States for at least a portion of the time the student attended the educational institution. Furthermore, a student attending the educational institution in the preceding taxable year who was studying abroad in a foreign country is considered to have been a student located in the United States if the student resided in the United States for at least a portion of the time the student attended the educational institution. However, if a student did not reside in the United States for any portion of the time the student attended the education institution during the preceding taxable year, then that student would not be considered to have been located in the United States for purposes of section 4968(b)(1)(B) (although he or she may still be considered a student for purposes of section 4968(b)(1)(D)). The Treasury Department and the IRS request comments on whether further guidance is needed relating to whether a student is considered to have been located in the United States in a preceding taxable year.

iv. Full-time Students and Part-time Equivalents

Section 4968(b)(2) provides, in part, that the number of students of an applicable educational institution (including for purposes of determining the number of students at a particular location) is based on the daily average number of full-time students attending such institution, with part-time students taken into account on a full-time student equivalent basis. Section 4968 does not define the terms "full-time" and "part-time" for purposes of the full-time equivalent rule in section 4968(b)(2), nor does it provide how to determine a full-time student equivalent or a daily average. Section 1.25A-3(d)(1)(ii) of the Income Tax Regulations provides for section 25A purposes that the standard for what is half the normal full-time work load is determined by each eligible educational institution; however, the standard for half-time may not be lower than the applicable standard for half-time established by the HEA.

Unlike section 25A, section 4968 does not require that a student be carrying at least half the normal full-time work load for the course of study the student is pursuing in order to be considered a student. However, the Treasury Department and the IRS otherwise view the standard provided in §1.25A-3(d)(1)(ii) as a helpful model in applying the full-time equivalent requirement in section 4968(b)(2) and propose to follow a similar approach.

Accordingly, these proposed regulations provide that, for purposes of section 4968(b)(2), the determinations of full-time students, part-time students, full-time student equivalents, and daily average of students attending the institution are made by each applicable educational institution as long as the determinations are consistent with the institution's practices in determining full-time and part-time status for other purposes. For example, it may be reasonable for an institution to determine that two students, each carrying half a full-time load, are equivalent to one full-time student. However, the standards an institution uses may not be lower than the applicable standards established by the Department of Education under the HEA.

The Treasury Department and the IRS seek comments on whether more specific guidance is required concerning the determination of full-time student, part-time student, full-time equivalent, or daily average number of full-time students attending the institution.

C. Assets Used Directly in Carrying out an Institution's Exempt Purpose

i. In General

To be included within the definition of applicable educational institution under section 4968(b)(1), an institution must have assets (other than those assets which are used directly in carrying out the institution's exempt purpose) the aggregate fair market value of which is at least $500,000 per student. The phrase "assets which are used directly in carrying out the institution's exempt purpose" is not defined in section 4968, but a similar phrase is used in section 4942.

For purposes of section 4942, a private foundation must determine its minimum investment return as part of its calculation of its distributable amount for any taxable year. Minimum investment return is defined in section 4942(e) as 5 percent of the excess of the aggregate fair market value of all assets of the foundation "other than those which are used (or held for use) directly in carrying out the foundation's exempt purpose," over the acquisition indebtedness with respect to such assets.

Since section 4968 contains a phrase similar to the language used in section 4942 (other than the omission of the parenthetical "or held for use"), the Treasury

Department and the IRS propose generally to follow §53.4942(a)-2(c) for purposes of determining whether an educational institution's assets are used directly in carrying out the institution's exempt purpose, without regard to provisions relating to private foundation assets "held for use." The Treasury Department and the IRS seek comments on whether the use of the principles of the section 4942 regulations for this purpose creates any concerns.

Consistent with section 4942, the proposed regulations provide in §53.4968-1(a)(4)(i) that an asset is used directly in carrying out an institution's exempt purpose only if the asset is actually used by the institution in carrying out its exempt purpose. Administrative assets, real estate, and physical property used by the institution directly in its exempt activities are all examples of such exempt purpose assets. In addition, a reasonable cash balance necessary to cover current administrative expenses and other normal and current disbursements directly connected with the educational institution's exempt activities is considered to be used directly in carrying out the institution's exempt purpose. For section 4942 purposes, a reasonable cash balance is defined as 1.5 percent of the fair market value of the private foundation's non-charitable use assets (i.e., assets not actually used by an institution in carrying out its exempt purpose), determined without regard to the reduction for the reasonable cash balance. For consistency with the 4942 rules, the Treasury Department and the IRS propose that a cash balance of 1.5 percent of the fair market value of the educational institution's non-charitable use assets, determined without regard to the deduction for the reasonable cash balance, will be deemed to be a reasonable cash balance for purposes of section 4968. However, the Treasury Department and the IRS note that the 1.5 percent standard in the section 4942 context is an average monthly amount over the entire taxable year and thus has to take into account fluctuations in cash needs. Thus, in light of the differences in the exempt activities of an educational institution and the section 4968 requirement to measure the assets only at the end of the taxable year, the Treasury Department and the IRS request comments on whether another percentage or other measurement should be deemed to be a reasonable cash balance at the end of the taxable year. The Treasury Department and the IRS specifically request comments supporting why any such other amount would be reasonable, and how utilizing a different amount would be administrable.

The proposed regulations do not address whether a functionally-related business would be considered an exempt use asset for the purposes of this test. Although functionally-related businesses are included as an illustration of an exempt use asset in the section 4942 regulations, it is not clear how the concept of a functionally-related business would apply to an educational institution. The Treasury Department and the IRS request comments on whether and how educational institutions use functionally related businesses in conducting their operations and whether functionally-related businesses should be explicitly included or excluded as examples of exempt use assets in the final regulations.

Whether an asset is used directly by an educational institution to carry out its exempt purpose is determined based on the facts and circumstances. In addition, where property is used both for charitable, educational, or other similar exempt purposes and for other purposes, if the exempt use represents 95 percent or more of the total use, the property is considered to be used exclusively for a charitable, educational, or other similar exempt purpose. If the exempt use represents less than 95 percent of the total use, the institution must make a reasonable allocation between the exempt and nonexempt use.

ii. Exceptions

Similar to the rules under section 4942, the proposed regulations deem certain assets to not be used directly in carrying out an institution's exempt purpose, including assets that are held for the production of income or for investment (for example, stocks, bonds, interest-bearing notes, endowment funds, or, generally, leased real estate), even if the income from such assets is used to carry out the exempt purpose. Similarly, non-exempt use assets include property used for managing endowment funds of the institution.

iii. Valuation of Assets not Used Directly in Carrying out an Institution's Exempt Purpose

For purposes of section 4968(b)(1)(D), the value of an institution's non-exempt use assets must be determined as of the last day of each taxable year for which a valuation must be made. In contrast, section 4942(e)(2)(A) provides generally that a foundation's securities for which market quotations are readily available shall be determined on a monthly basis, and that the values of other assets shall be determined at such times and in such manner as the Secretary shall by regulations prescribe.

Section 53.4942(a)-2(c)(4) provides that a private foundation may use any reasonable method to determine the fair market value on a monthly basis of securities for which market quotations are readily available, as long as such method is consistently used, and provides additional valuation guidelines for assets that are not market securities.

Consistent with the proposed rules for determining whether an asset is used directly in carrying out an institution's exempt purpose, the Treasury Department and the IRS propose that, for purposes of valuing the institution's non-exempt use assets, institutions use rules similar to the rules of section 4942(e) and §53.4942(a)-2(c)(4), with two modifications. First, the phrase "applicable educational institution" is substituted for "private foundation" or "foundation" every place they appear. Second, an institution will have to make such adjustments as are reasonable and necessary to obtain the fair market value of non-exempt use assets as of the last day of the valuation taxable year, rather than any other frequency provided by the section 4942 regulations.

The Treasury Department and the IRS request comments on valuing exempt use assets using the principles of section 4942, as modified by this special timing rule.

2. Determination of Net Investment Income and Basis of Property

A. In General

Section 4968(a) imposes on each applicable educational institution a tax equal to

1.4 percent of its net investment income for the taxable year. Section 4968(c) provides that net investment income is determined under rules similar to the rules of section 4940(c). Accordingly, the proposed regulations provide in §53.4968-1(b) that an institution must calculate its net investment income under the rules of section 4940(c) and §53.4940-1(c) through (f), with certain modifications explained in part 2(B) of this Explanation of Provisions section.

Section 4940(c)(1) defines net investment income as the amount by which the sum of the gross investment income and the capital gain net income exceeds certain specified allowable deductions. Section 4940(c)(1) also states that, except to the extent inconsistent with the provisions of section 4940, net investment income is determined under the principles of subtitle A of the Code.

Section 4940(c)(2) provides that, for purposes of section 4940(c)(1), gross investment income means the gross amount of income from interest, dividends, rents, payments with respect to securities loans (as defined in section 512(a)(5)), and royalties, but not including any such income to the extent included in computing the unrelated business income tax imposed by section 511. The term gross investment income also includes income from sources similar to those specifically listed in the preceding sentence.

Section 4940(c)(3) provides that, for purposes of section 4940(c)(1), there is allowed as a deduction all the ordinary and necessary expenses paid or incurred for the production or collection of gross investment income or for the management, conservation, or maintenance of property held for the production of such income, determined with the following modifications: (1) the deduction provided by section 167 is allowed, but only on the basis of the straight line method of depreciation; and (2) the deduction for depletion provided by section 611 is allowed, but is determined without regard to section 613 (relating to percentage depletion).

Section 4940(c)(4) provides that, for purposes of determining capital gain net income under section 4940(c)(1), (1) no gain or loss from the sale or other disposition of property is taken into account to the extent that any such gain or loss is taken into account for purposes of computing the tax imposed by section 511 on unrelated business taxable income; (2) in the case of property held by a private foundation on December 31, 1969, and continuously thereafter to the date of its disposition, the basis for determining gain is deemed to be not less than the fair market value of such property on December 31, 1969; (3) losses from sales or other dispositions of property are allowed only to the extent of gains from such sales or other dispositions, without capital loss carryovers or carrybacks; and (4) except to the extent provided by regulation, under rules similar to the rules of section 1031 (including the exception under subsection (a)(2) thereof relating to exchanges of real property held primarily for sale), no gain or loss is taken into account with respect to any portion of property used for a period of not less than 1 year for a purpose or function constituting the basis of the private foundation's exemption if the entire property is exchanged immediately following such period solely for property of like kind which is to be used primarily for a purpose or function constituting the basis for such foundation's exemption.

Section 4940(c)(5) provides that, for purposes of section 4940, net investment income is determined by applying section 103 (relating to State and local bonds) and section 265 (relating to expenses and interest relating to tax-exempt income).

Section 4968 does not expressly provide that the tax on net investment income is limited to net investment income derived from assets that are not used directly in carrying out an applicable educational institution's exempt purpose. This lack of a limitation is in contrast to the specific language in section 4968(b)(1)(D) that excludes assets used directly in carrying out an institution's exempt purpose in determining whether the educational institution is an applicable educational institution. Instead, section 4968(c) provides that net investment income shall be determined under rules similar to the rules of section 4940(c). Accordingly, these proposed regulations adopt the rules provided in section 4940(c) and the regulations thereunder, including §53.4940-1(d)(1), which specifies that "gross investment income" means the gross amounts of income from interest, dividends, rents, royalties (including overriding royalties), and capital gain net income received by a private foundation from all sources, but does not include such income to the extent included in computing the tax imposed by section 511. Under this definition, consistent with specific language in §53.4940-1(d), interest, dividends, rents, and royalties derived from assets devoted to charitable activities are includible in gross investment income. Therefore, for example, interest received on a student loan would be includible.

The Treasury Department and the IRS request comments on whether specific types of income should be excluded from gross investment income under section 4968 because taxing those types of income would not achieve the congressional intent in enacting section 4968. In explaining why each such type of income should be excluded, please state specifically how the proposed exclusion is still "similar to" the rules of section 4940(c) and the specific characteristics of each type of such income that would warrant deviating from the rules provided in section 4940 and the regulations thereunder.

For example, the rules of section 4940(c) specifically include student loan interest as net investment income. However, the Treasury Department and the IRS recognize that student loans provided directly by an applicable educational institution to its students can be seen as helping the applicable educational institution fulfill its mission of educating its students. Unlike private foundations, colleges and universities educate students and charge tuition as part of their primary exempt activities. Student loans provided by an applicable educational institution to its students arguably can be viewed as a form of deferred tuition which will be paid when the student enters the workforce. Under this rationale, the interest on the student loan may arguably be distinguished from investment income, depending on the interest rate. If the interest is at a market (or higher) rate, it would be difficult to distinguish the interest on the student loan and interest on assets acquired for investment purposes. However, if the interest rate is set at a substantially below-market rate, the difference between the market interest rate and the interest rate on the student loan might be viewed as similar to a scholarship from the school to the student. Under these circumstances, the remaining, below-market rate interest income might be considered distinguishable from income derived from assets acquired primarily for investment purposes.

Any exception for student loan interest that is premised on the utilization of an interest rate that is substantially lower than a market rate would potentially present tax administrative challenges for both the IRS and taxpayers in determining the relevant market-rate and an acceptable lower rate, and in adjusting to rate changes during the course of the loan. Comments advocating an exception for the interest received on student loans should explain how these concerns could be addressed. It would be helpful if such comments also provide information regarding the number of student loans applicable educational institutions make each year, how they set the interest rates on those loans, and whether the rates are set below market, or at market rates.

Allowing an exception from net investment income for certain categories of student loan interest would raise the question of why only those categories of exempt function income are excluded from net investment income. Many other categories of income derived from exempt functions also help an applicable educational institution fulfill its exempt purposes. Private foundations might also argue that many of their types of income help them fulfill their exempt purposes. The Treasury Department and the IRS request comments on why interest income on student loans provided by an applicable educational institution to its students is a logical place to draw the line at the type of income that should be excluded from the net investment income tax, especially given the reference to student loan income in §1.4940-1(d).

Similarly, under section 4940(c), net investment income includes rents. The Treasury Department and the IRS recognize that colleges and universities offer various types of housing (such as dormitories or apartments) for use by students, non-students (for example, during the summer), and faculty. The Treasury Department and the IRS request comments on the differences, if any, among the housing arrangements, whether any of the arrangements include the signing of leases, the various amounts charged by a college or university related to provision of housing and meals, and particular factors that distinguish room and board payments from students living in a dormitory from rental income that institutions receive.

Consistent with the requirement in section 4968(c) to calculate net investment income under rules similar to the rules under section 4940(c), these proposed regulations generally follow the rules for determining gain upon the sale or other disposition of property that have been used for section 4940(c) purposes since 1969. Section 4940(c)(1) provides that, except to the extent inconsistent with the provisions of section 4940, net investment income is determined under the principles of subtitle A. Subtitle A encompasses all of the income tax provisions (sections 1 through 1564) of the Code, including the basis rules in section 1015 (basis of property acquired by gift is generally the same as the donor's basis). Accordingly, under the proposed regulations, an applicable education institution computes gain on the sale or disposition of donated property using the donor's basis. The Treasury Department and the IRS request comments on whether a special rule excluding any appreciation in a gift of donated property that occurred before the date of receipt by the applicable educational institution should be included in the final regulations and how such a special rule would be consistent with the statutory language of section 4968.

B. Special Rules

The proposed regulations provide in §53.4968-1(b)(3) that an institution should substitute "applicable educational institution" for "private foundation" or "foundation" every place it appears in §53.4940-1(c) through (f). In addition, the proposed regulations provide that the rule in §53.4940-1(d)(3) does not apply because it is narrowly focused on section 302 stock redemptions by corporations that are disqualified persons when the redemptions are part of a transaction designed to reduce section 4943 excess business holdings. Colleges and universities are not subject to section 4943, so they cannot have excess business holdings that could be the subject of a section 302 stock redemption by a disqualified person corporation.

As provided by section 3 of Notice 2018-55 (2018-26 I.R.B. 773), in following the rule in section 4940(c)(4), the proposed regulations substitute "December 31, 2017" for "December 31, 1969" every place it occurs. In addition, in response to a comment requesting clarification of the basis rules for assets held in a partnership on December 31, 2017, these proposed regulations also provide that if an applicable educational institution held an interest in a partnership (including through one or more tiers of partnerships) on December 31, 2017, and continuously thereafter, and the partnership held assets on December 31, 2017, and continuously thereafter to the date of disposition, the partnership's basis in its assets with respect to the applicable educational institution for purposes of determining the applicable educational institution's share of gain upon sale or disposition of the assets shall be not less than the fair market value of such asset on December 31, 2017, plus or minus all adjustments after December 31, 2017, and before the date of disposition. For purposes of applying this special partnership basis rule, an institution must obtain documentation from the partnership to substantiate the claim.

Finally, consistent with section 4 of Notice 2018-55 and section 4940(c)(4)(C), the proposed regulations provide that in applying §53.4940-1(f), overall net losses from sales or other dispositions of property by one related organization (or by the applicable educational institution) shall reduce (but not below zero) overall net gains from such sales or other dispositions by other related organizations (or by the applicable educational institution).

3. Related Organizations

Section 4968(d)(1) provides, in part, that for purposes of determining the aggregate fair market value of the assets and net investment income of an educational institution, the assets and net investment income of any related organization with respect to the educational institution shall be treated as assets and net investment income, respectively, of the educational institution.

For this purpose, the statute provides two special rules: (1) no such amount shall be taken into account with respect to more than 1 educational institution, and (2) unless such organization is controlled by such institution or is described in section 509(a)(3) (relating to supporting organizations) with respect to such institution for the taxable year, assets and net investment income which are not intended or available for the use or benefit of the educational institution shall not be taken into account. Section 53.4968-1(c) of these proposed regulations provides definitions and special rules relating to related organizations.

A. Definition of Related Organization

Section 4968(d)(2) provides that the term "related organization" means, with respect to an applicable educational institution, any organization which (1) controls, or is controlled by, such institution; (2) is controlled by 1 or more persons which also control such institution; or (3) is a supported organization (as defined in section 509(f)(3)) or a supporting organization (as described in section 509(a)(3)) during the taxable year with respect to such institution.

Section 4968(d)(2) does not define the term "control." The concept of controlled entities is found in numerous other areas of the Code, including section 4960, which was enacted at the same time as section 4968. Consistent with the position taken in Notice 2019-09, "Interim Guidance Under Section 4960" (2019-04 I.R.B. 403), for purposes of defining "control" within the meaning of section 4968(d), these proposed regulations provide rules based on the definition of control under section 512(b)(13)(D) and the regulations thereunder, which includes the constructive ownership rules of section 318, and that generally align with the definition of related organization for purposes of the annual reporting requirements on Form 990. The Treasury Department and the IRS request comments on whether there are any circumstances in which this definition of control should be modified in the context of section 4968.

Thus, the proposed regulations provide in §53.4968-1(c)(1) that the term "control" means (1) in the case of a corporation, ownership (by vote or value) of more than 50 percent of the stock of the corporation; (2) in the case of a partnership, ownership of more than 50 percent of the profits interests or capital interests in such partnership; (3) in the case of a trust with beneficial interests, ownership of more than 50 percent of the beneficial interests in the trust; or (4) in the case of a nonprofit organization or other organization without owners or persons having beneficial interests (nonstock organization), including a governmental entity, that more than 50 percent of the directors or trustees of the applicable educational institution or nonstock organization are either representatives of, or are directly or indirectly controlled by, the other entity or that more than 50 percent of the directors or trustees of the nonstock organization are either representatives of, or are directly or indirectly controlled by, one or more persons that control the applicable educational institution. For purposes of this paragraph, a "representative" means a trustee, director, agent, or employee, and control includes the power to remove a trustee or director and designate a new trustee or director. Finally, section 318, which contains rules for determining constructive ownership of stock, applies for purposes of determining ownership of stock in a corporation, and similar principles apply for purposes of determining ownership of an interest in any other entity. The Treasury Department and the IRS do not propose to adopt the test for control under section 414(b) and (c), which generally uses the same test for control of a nonprofit organization as section 512(b)(13)(D) except that it replaces the 50-percent threshold with an 80-percent threshold. Instead, the proposed regulations adopt the control test under section 512(b)(13)(D) to align more closely with other exempt organization control tests and to ensure consideration of available assets consistent with congressional intent that would not occur under the higher 80 percent control threshold that was established for qualified plans.

Since the net investment that a taxable entity provides to an applicable educational institution has already been taxed under section 1, the Treasury Department and the IRS do not consider it consistent with congressional intent to tax the income again under section 4968. Furthermore, with regard to the assets of a taxable entity that is a related organization defined in section 4968(d)(2)(A) or (B), the institution likely already has included the value of the stock in its non-exempt use assets; however, the stock value may differ from the value of the taxable entity's underlying assets. The Treasury Department and the IRS request comments on how to account for this difference without double-counting the assets, as well as comments on the treatment of taxable entities that are related organizations for purposes of section 4968.

B. Assets and Net Income Treated as Assets and Net Income of Only One Educational Institution

As noted above, section 4968(d)(1)(A) provides, in part, that for purposes of determining the aggregate fair market value of an institution's assets and its net investment income, the assets and net investment income of any related organization with respect to the educational institution shall be treated as assets and net investment income, respectively, of the educational institution. However section 4968(d)(1)(A) provides an exception under which no such amount shall be taken into account with respect to more than 1 educational institution.

In order to effectuate section 4968(d)(1)(A), the proposed regulations provide in §53.4968-1(c)(2)(ii)(A) that, in any case in which an organization is a related organization with respect to more than 1 educational institution, the assets and net investment income of the related organization must be allocated between the educational institutions being supported by the related organization. The proposed regulations provide that such allocation must be made in a reasonable manner, taking into account all facts and circumstances, and must be consistently applied across all related organizations. The Treasury Department and the IRS request comments on whether more specific guidance is required concerning the allocation of a related organization's assets and net investment income between multiple educational institutions being supported by the same related organization, and if so, what such additional guidance should provide.

C. Assets and Net Investment income "Not Intended or Available for the Use or Benefit of" an Educational Institution

For purposes of attributing assets and net investment income of related organizations to applicable educational institutions, section 4968(d)(1)(B) provides that, unless a related organization is controlled by the educational institution or is described in section 509(a)(3) with respect to such institution for the taxable year, assets and net investment income of the related organization that are not intended or available for the use or benefit of the educational institution shall not be taken into account. Put another way, if a related organization controls the educational institution or is controlled by 1 or more persons which also control such institution but is not described in section 509(a)(3) with respect to the educational institution for the taxable year, then the assets and net investment income of the related organization are taken into account as assets and net investment income of the educational institution only if the assets and net investment income are intended or available for the use and benefit of the educational institution. However, if a related organization is either controlled by the educational institution or is described in section 509(a)(3) with respect to such institution for the taxable year, then all the assets and net investment income of the related organization are considered assets and net investment income of the educational institution, except as provided below.

The Conference Report description of section 4968 repeats section 4968(d)(1)(B) and adds, "[f]or example, assets of a related organization that are earmarked or restricted for (or fairly attributable to) the educational institution would be treated as assets of the educational institution, whereas assets of a related organization that are held for unrelated purposes (and are not fairly attributable to the educational institution) would be disregarded." H. Rept. 115-466, 115th Cong., 1st sess., at 555 (December 15, 2017).

Thus, the proposed regulations provide in §53.4968-1(c)(2)(ii)(B) that when a related organization controls an educational institution or is controlled by 1 or more persons which also control such institution and is not described in section 509(a)(3) with respect to the educational institution, the assets and net investment income of a related organization must be allocated between those intended or available for the use and benefit of an educational institution and those not intended or not available for the use and benefit of that educational institution. Such allocation must be made in a reasonable manner, taking into account all facts and circumstances, and must be consistently applied across all related organizations.

The proposed regulations further explain that assets and net investment income of such a related organization are intended or available for the use and benefit of an educational institution if such assets and net investment income are specifically earmarked or restricted for the benefit of, or are otherwise fairly attributable to, the educational institution. Conversely, assets and net investment income of a related organization are not intended or available for the use and benefit of an educational institution if such assets and net investment income are specifically earmarked or restricted for another entity or for unrelated purposes or are otherwise not fairly attributable to the educational institution. For purposes of this required allocation, the Treasury Department and the IRS request comments on situations in which an organization's assets or net investment income is not specifically earmarked or restricted for the benefit of any particular organization but is otherwise fairly attributable to the educational institution or to another organization. For example, absent any earmarking or restriction, should total distributions from a related organization to an applicable educational institution in one taxable year establish a presumption for section 4968 purposes that at least an equal amount is fairly attributable to the applicable educational institution for the following taxable year, absent demonstrated facts and circumstances supporting attribution of a lesser amount?

Because section 4968(d)(1)(B) carves out organizations that are controlled by an institution or are described in section 509(a)(3) with respect to such institution for the taxable year from this special rule, the proposed regulations provide that if the related organization is controlled by the educational institution or is described in section 509(a)(3) with respect to the educational institution, the assets and net investment income of the related organization must be taken into account as assets and net investment income of the educational institution, regardless of whether the assets and net investment income are earmarked or restricted for the benefit of, or otherwise fairly attributable to, the educational institution and even if they are specifically earmarked or restricted for another entity or for unrelated purposes or are otherwise not fairly attributable to the educational institution. However, the special rule in section 4968(d)(1)(A) continues to apply, such that the assets and net investment income of the related organization are not taken into account by more than one educational institution. See part 3(B) of the Explanation of Provisions section.

In recognition that section 509(a)(3) Type III supporting organizations, unlike section 509(a)(3) Type I and Type II supporting organizations, are not controlled by their supported organizations,[3] and because applicable educational institutions may not be able to get information from their Type III supporting organizations, the proposed regulations provide a special rule in §53.4968-1(c)(2)(ii)(B)(*3*)(*ii*) for related organizations of an educational institution that were Type III supporting organizations with respect to the applicable educational institution on December 31, 2017. The proposed

[3] Organizations described in section 509(a)(3) are known as "supporting organizations." Supporting organizations achieve their public charity status by providing support to one or more organizations described in section 509(a)(1) or (2), which, in this context, are referred to as "supported organizations." To be described in section 509(a)(3), an organization must satisfy several tests, including having one of three "relationships" with one or more supported organizations. A supporting organization that is operated, supervised or controlled by one or more supported organizations is known as a "Type I" supporting organization. A supporting organization that is supervised or controlled in connection with one or more supported organizations is known as a "Type II" supporting organization. A supporting organization that is operated in connection with one or more supported organizations is known as a "Type III" supporting organization. The relationship of a Type III supporting organization with its supported organization(s) is much more attenuated than the other two types.

regulations provide that an applicable educational institution with a related organization that was a Type III supporting organization with respect to the applicable educational institution on December 31, 2017, may take into account only the assets and net investment income of the related Type III supporting organization that are intended or available for the use and benefit of the applicable educational institution, as described in this part 3(C) of the Explanation of Provisions section. An applicable educational institution can determine whether the assets and net investment income of such a Type III supporting organization are intended or available for the use and benefit of the applicable educational institution using any reasonable method. A method using all the distributions received from the Type III supporting organization subject to this special rule as net investment income of the applicable educational institution each year will be deemed to be reasonable. Similarly, a method using the distributions received from the Type III supporting organization to calculate the percentage of the Type III supporting organization's total net income that was distributed to the applicable educational institution, and using the same percentage to calculate the value of the underlying assets of the Type III supporting organization that are intended or available for the use and benefit of the applicable educational institution each year, will be deemed to be reasonable. The Treasury Department and the IRS request comments on whether additional guidance pertaining to Type III supporting organizations is needed.

Special Analyses

Executive Orders 12866 and 13563 direct agencies to assess costs and benefits of available regulatory alternatives and, if regulation is necessary, to select regulatory approaches that maximize net benefits (including potential economic, environmental, public health and safety effects, distributive impacts, and equity). Executive Order 13563 emphasizes the importance of quantifying both costs and benefits, of reducing costs, of harmonizing rules, and of promoting flexibility.

The proposed regulations have been designated by the Office of Management and Budget's (OMB) Office of Information and Regulatory Affairs (OIRA) as subject to review under Executive Order 12866 pursuant to the Memorandum of Agreement (April 11, 2018) between the Treasury Department and OMB regarding review of tax regulations. OIRA has determined that the proposed rulemaking is significant and subject to review under Executive Order 12866 and section 1(b) of the Memorandum of Agreement. Accordingly, the proposed regulations have been reviewed by OMB.

I. *Need for Regulation*

The Conference Report, at 555, states that Congress intended that the Secretary promulgate regulations to carry out the intent of section 4968. These proposed regulations are in response to this congressional intent. The proposed regulations provide guidance for determining the excise tax applicable to the net investment income of certain private colleges and universities, as provided by the TCJA. The regulations are intended to clarify which educational institutions are subject to the excise tax under section 4968 (excise tax) and how net investment income is calculated for purposes of this excise tax.

Prior to these proposed regulations, the Treasury Department and the IRS have not issued formal guidance on the definitions of these terms or on the rules under which net investment income for purposes of the excise tax in section 4968 were determined.[4] As a result, there was a degree of taxpayer uncertainty as to the definitions of the various terms and whether net investment income would be determined under rules identical to or similar to the rules of section 4940(c), and if the latter, what the deviations from the rules of section 4940(c) would be.

Pursuant to section 6(a)(3)(B) of Executive Order 12866, the following qualitative analysis provides further details regarding the anticipated impacts of the proposed regulations. After describing briefly the statute and the proposed regulations in Part II, the baseline used for the analysis is described in Part III of this Special Analyses section. Part IV of this Special Analyses section describes the types of entities affected by the proposed regulations. Part V of this Special Analyses section provides a qualitative assessment of the potential economic effects, including the benefits and costs, of the proposed regulations compared to the baseline.

II. The Statute and the Proposed Regulations

Section 4968 imposes a 1.4 percent excise tax on the net investment income of applicable educational institutions. Under the statute, an "applicable educational institution" is an eligible educational institution (which is described in section 481 of the Higher Education Act of 1968) that has at least 500 tuition-paying students during the preceding taxable year, more than 50 percent of the tuition-paying students of which are located in the United States, is not a state college or university, and the fair market value of the assets of which (other than those assets which are used directly in carrying out the institution's exempt purpose) is at least $500,000 per student at the end of the preceding taxable year. Under section 4968, net investment income is determined under rules "similar to" the rules of section 4940(c) (the rules for calculation of the net investment income of private foundations). In addition, the assets and net investment income of related organizations are generally treated as the assets and net investment income of the educational institution.

Section 4968 does not define the terms "student," "tuition-paying student," or "assets used directly in carrying out the institution's exempt purpose." Section 4968(c) states that, for the purposes of the excise tax in section 4968, net investment income shall be determined under rules "similar to" the rules of section 4940(c), but does not define what is meant by "similar to." Section 4968 does not define the term "control" as it relates to a "related organization with respect to an educational institution." The proposed regulations

[4] In June 2018, the Treasury Department and the IRS issued Notice 2018-55 (2018-26 I.R.B. 773) to provide clarification regarding the calculation of net investment income for purposes of section 4968(c). The Notice stated that the Treasury Department and the IRS intended to issue proposed regulations relating to those and other issues.

provide general definitional guidance with respect to these and other terms and rules relevant to the statute. A brief discussion of this guidance follows.

The proposed regulations define "student" to mean, in general, "a person enrolled in a degree, certification, or other program (including a program of study abroad approved for credit by the eligible institution at which such student is enrolled) leading to a recognized educational credential at an institution, and who is not enrolled in an elementary or secondary school." The proposed regulations define "tuition-paying" to mean, in general, "the payment of any tuition or fees required for the enrollment or attendance of a student for a course of instruction at an educational institution." These definitions follow similar definitions in section 25A of the Code. The proposed regulations also provide guidance for determining whether a student is located in the U.S. and for counting full-time and full-time equivalent students.

The proposed regulations define "assets used directly in carrying out an institution's exempt purpose" to mean, in general, assets "actually used by the institution in carrying out its exempt purpose." Whether an asset qualifies "must be determined based on all the facts and circumstances." If the property's "exempt use represents 95 percent or more of the total use, the property is considered to be used exclusively for an exempt purpose. If the exempt use of such property represents less than 95 percent of the total use, the institution must make a reasonable allocation between such exempt and nonexempt uses."

The proposed regulations state that the valuation of assets not used directly in carrying out an institution's exempt purpose is determined under the rules of section 4942 and its regulations, with two modifications. First, "educational institution" is substituted for "private foundation" or "foundation" each place they appear. Second, the educational institution must obtain the fair market value of assets on the last day of the preceding taxable year rather than at other times provided by the regulations under section 4942.

Consistent with 4968(c), the proposed regulations state that net investment income will be determined under the rules of section 4940(c) and its regulations, with five modifications. First, "applicable educational institution" is substituted for "private foundation" or "foundation" each place they appear. Second, the regulations relating to the treatment of certain distributions in redemption of stock do not apply to applicable educational institutions. Third, December 31, 2017, replaces December 31, 1969 (the date used for the excise tax on net investment income of private foundations under section 4940(c)), to determine the basis of assets held on December 31, 2017, for purposes of calculating the excise tax. Fourth, if an applicable educational institution held an interest in a partnership on December 31, 2017, and continuously thereafter, and the partnership held assets on December 31, 2017, and continuously thereafter to the date of disposition, generally the basis of those assets for determining the applicable educational institution's share of gain upon sale or disposition of the assets is not less than the fair market value of such assets on December 31, 2017, plus or minus adjustments provided under the regulations for section 4940 after December 31, 2017, and before the date of disposition. Fifth, overall net losses from sales or other dispositions of property by one related organization or by the applicable educational institution may reduce (but not below zero) overall net gains from such sales or other dispositions by other related organizations or by the applicable educational institution.

Following the rules for section 4960, the proposed regulations define the term "control," as it relates to a "related organization with respect to an educational institution," generally to mean ownership of more than 50 percent of (a) the stock of a corporation, (b) the profits interests or capital interests in a partnership, or (c) the beneficial interests of a trust. For a nonstock corporation, control means (a) more than 50 percent of the directors or trustees of the applicable educational institution or nonstock organization are either representatives of, or are directly or indirectly controlled by, the other entity, or (b) more than 50 percent of the directors or trustees are representatives of, or are directly or indirectly controlled by, one or more persons that control the applicable educational institution. The proposed regulations apply the principles of section 318 for purposes of determining ownership of stock in a corporation and apply similar principles for purposes of determining ownership of an interest in any other entity.

The proposed regulations also provide an allocation rule to effectuate section 4968(d)(1)(A) (providing that income be taken into account by no more than one institution) and 4968(d)(1)(B) (providing that only assets available for use by the institution be taken into account in determining the aggregate amount of assets), in the case of related organizations.

III. *Baseline*

The Treasury Department and the IRS have assessed the benefits and costs of the proposed regulations relative to a no-action baseline reflecting anticipated Federal income tax-related behavior in the absence of these proposed regulations.

IV. *Affected Entities*

One researcher used data from the Integrated Post-Secondary Education Data System (IPEDS) on endowment values at the end of the 2015-2016 academic year and enrollment data to estimate the number of institutions at risk of having liability under this excise tax.[5] Under the assumption that none of the assets in the endowment are for exempt purposes, he estimates that 23 institutions are likely to be currently subject to tax. Using the same IPEDS data, another researcher estimated that in 2016, among four-year public and not-for-profit private institutions located in the United States with at least 500 full-time equivalent students, and excluding endowments held at the university system level, there were 27 endowments worth at least $500,000 per student.[6] These estimates do not take into account all of the provisions of the statute and regulations. For example, limiting this set of institu-

[5] Levine, Phillip. "The University Endowment Income Tax: Who Will Pay it and Why Was it Implemented?", Econofact, January 25, 2018, available at https://econofact.org/the-university-endowment-tax-who-will-pay-it-and-why-was-it-implemented, accessed April 29, 2019.

[6] Hinrichs, Peter. "College Endowments." Economic Commentary 2018-04 (May 17, 2018), Federal Reserve Bank of Cleveland, Table 1.

tions to the not-for-profit private institutions subject to tax and excluding assets that are used for the institutions' exempt purpose would reduce the number of affected institutions. On the other hand, as both authors note, because the $500,000 per student threshold for the aggregate fair market value of assets (other than those assets which are used directly in carrying out the institution's exempt purpose) that in part determines whether the excise tax in section 4968 applies to an educational institution is not indexed for inflation, the number of institutions to which the excise tax in section 4968 applies is expected to increase over time. In addition, these studies did not consider assets held by related organizations; including such assets could increase the number of affected schools.

V. *Economic Effects of the Proposed Regulations*

The proposed regulations clarify a number of definitions related to the excise tax in section 4968. In the absence of guidance, affected taxpayers would have to calculate their tax liability without the definitions and clarifications provided by the proposed regulations, a situation that is generally considered more burdensome and could lead to greater conflicts with tax administrators. The proposed regulations make use of a number of existing statutory and regulatory provisions in defining students, tuition, exempt purpose, fair market value, net investment income and related organizations. Many taxpayers will already be familiar with these definitions. Thus, although the Treasury Department and the IRS project that the proposed regulations will reduce taxpayer compliance burden, including determining whether the excise tax applies to the institution and the time needed to file the return, and the costs of tax administration, including monitoring the compliance of taxpayers with the excise tax, relative to the no-action baseline, it is possible that the proposed regulations will have other economic effects.

The guidance provided in the proposed regulations also ensures that the excise tax liability is calculated similarly across taxpayers, avoiding situations where one taxpayer receives preferential treatment over another taxpayer for fundamentally similar economic activity. For example, in the absence of these proposed regulations, an applicable educational institution may have uncertainty over whether it is subject to the excise tax under section 4968 and what assets are used in determining the net investment income for purposes of the excise tax under section 4968. As a result, in the absence of guidance, similar institutions might take different positions and pay different amounts of tax, introducing economic inefficiency and inequity.

Based on this analysis, the Treasury Department and the IRS anticipate the net economic contribution of the proposed regulations will be modest, and will be positive relative to not issuing any such guidance and conditional on the relevant statutes. However, as stated earlier in the preamble, the Treasury Department and the IRS request comments on a number of aspects of the proposed regulations, which could include comments on the economic effects, any behavioral changes caused, or the unintended costs and benefits of the proposed regulations.

These proposed regulations provide further clarity on the Treasury Department and IRS policy choices regarding the treatment of investment income under section 4968, including the relationship to section 4940(c). Treasury Department and IRS requests comment on the proposed definitions and treatment of investment income in these regulations.

Paperwork Reduction Act

The collection of information in these proposed regulations is in §§53.4968-1(a)(2), (3), and (4), and 53.4968-1(b) and (c)(1) and (2). This information is required to determine whether an educational institution is an applicable educational institution, as defined in section 4968(b); to calculate net investment income as defined in section 4968(c); and to determine the assets and net investment income of related organizations that are treated as assets and net investment income of applicable educational institutions, as defined in section 4968(d). In 2016, the IRS released and invited comments on drafts of an earlier version of Form 4720 in order to give members of the public the opportunity to benefit from certain specific amendments made to the Code. The IRS received no comments on Form 4720 during the comment period. Consequently, the IRS made Form 4720 available on December 9, 2016 for use by the public. The IRS is contemplating making additional changes to Form 4720 based on these regulations. The IRS intends that the burden of the collections of information will be reflected in the burden associated with Form 4720, OMB approval number 1545-0052.

The burden associated with Form 4720 is included in the aggregated burden estimates for OMB control number 1545-0052 (listing a total estimated burden time for all Form 4720 filers of 88,839 hours and total estimated monetized costs of $8.441 million ($2017)). The burden estimates provided for Form 4720 are aggregate amounts that relate to all filers associated with the form, and will in the future include, but not isolate, the estimated burden of only those information collections associated with these proposed regulations. These numbers are therefore unrelated to the future calculations needed to assess the burden imposed by these regulations, specific burden estimates for which are not currently available. The Treasury Department and the IRS have not estimated the burden, including that of any new information collections, related to the requirements under the proposed regulations.

The expected burden for private colleges and universities that are applicable to this rule as described in section 4968(b) is listed below:

Estimated number of respondents: 40

Estimated average annual burden hours per response: 32 hours, 27 minutes

Estimated total annual burden: $123,336 (2017)

Estimated frequency of collection: Annual

The Treasury Department and the IRS request comments on all aspects of information collection burdens related to the proposed regulations, including estimates for how much time it would take to comply with the paperwork burdens described above for each relevant form and ways for the IRS to minimize the paperwork burden. Proposed revisions (if any) to these forms that reflect the information collections contained in these final regulations will be made available for public comment at *https://apps.irs.gov/app/picklist/list/draftTaxForms.html* and will not be finalized until after these forms have been approved by OMB under the PRA. Comments on these forms can be submitted at *https://www.irs.gov/forms-pubs/comment-on-tax-forms-and-publications*.

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

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

Regulatory Flexibility Act

Pursuant to the Regulatory Flexibility Act (5 U.S.C. chapter 6), it is hereby certified that these proposed regulations would not have a significant economic impact on a substantial number of small entities. As discussed elsewhere in this preamble, this rule merely provides definitions regarding the applicability of the section 4968 excise tax to certain private colleges and universities. The requirements in this regulation fall only on educational institutions the aggregate fair market values of the non-charitable use assets of which are at least $500,000 per student of the institution and that have at least 500 tuition-paying students (for a minimum investment asset value of $250,000,000).

This proposed rule would not affect a substantial number of small entities. Only about 1 percent of four-year colleges and universities (less than 30 out of over 2,400 institutions in the National Center for Education Statistics' Integrated Post-Secondary Education System Data for 2016) are expected to be affected by the tax. In addition, they are likely to have income from all sources exceeding $27.5 million, the threshold established by the Small Business Administration for an educational institution to be considered a small entity. This is because at a modest 4 percent rate of return, the minimum endowment alone would generate income of $10 million. To generate another $17.5 million in income would require receipts of $35,000 per student if the school had only the minimum number of students, compared to average tuition and fees at a four-year private school, which was $39,529[7] in 2015-16. Therefore, this rule is not likely to affect a substantial number of small entities.

Notwithstanding this certification, the Treasury Department and the IRS invite comments on the impact this rule may have on small entities.

Pursuant to section 7805(f) of the Code, this proposed rule has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small entities.

Comments and Requests for Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any comments that are timely submitted to the IRS as prescribed in the preamble under the **ADDRESSES** section. All comments submitted will be made available at *https://www.regulations.gov* or upon request.

A public hearing may 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 hearing will be published in the **Federal Register**.

Drafting Information

The principal authors of these regulations are Melinda Williams and Amber L. MacKenzie, Office of Associate Chief Counsel (Employee Benefits, Exempt Organizations, and Employment Tax). However, other personnel from the Treasury Department and the IRS participated in their development.

Statement of Availability of IRS Documents

IRS Revenue Procedures, Revenue Rulings, Notices, and other guidance cited in this document are published in the Internal Revenue Bulletin (or Cumulative Bulletin) and are available from the Superintendent of Documents, U.S. Government Publishing Office, Washington, DC 20402, or by visiting the IRS website at http://www.irs.gov.

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Proposed Amendments to the Regulations

Accordingly, 26 CFR part 53 is proposed to be amended as follows:

PART 53—FOUNDATION AND SIMILAR EXCISE TAXES

Paragraph 1. The authority citation for part 53 continues to read, in part, as follows:

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

Par. 2. Section 53.4968-1 is added to read as follows:

§53.4968-1 Excise tax based on investment income of certain private colleges and universities.

(a) *Excise tax on the investment income of certain private colleges and universities*—(1) *In general*. For taxable years beginning after December 31, 2017, section 4968 imposes a tax equal to 1.4 percent of the net investment income (as defined in section 4968(c) and paragraph (b) of this section) of an applicable educational institution (as defined in section 4968(b)(1) and paragraph (a)(2) of this section).

(2) *Applicable educational institution*. Under section 4968(b)(1) and for purposes of this section, the term *applicable educational institution* means any eligible educational institution as defined in section 25A(f)(2) and §1.25A-2(b) of this chapter—

(i) Which had at least 500 tuition-paying students attending the institution during the preceding taxable year;

(ii) More than 50 percent of the tuition-paying students attending the institution are located in the United States;

(iii) Which is not described in the first sentence of section 511(a)(2)(B) (relating to state colleges and universities); and

(iv) The aggregate fair market value of the assets of which at the end of such preceding taxable year (other than those assets that are used directly in carrying out the institution's exempt purpose) is at

[7] U.S. Department of Education, National Center for Education Statistics (2018). Digest of Education Statistics, 2016 (NCES 2017-094).

least $500,000 per student attending the institution.

(3) *Student*—(i) *In general*. For purposes of section 4968 and paragraph (a) of this section, the term *student* means a person enrolled in a degree, certification, or other program (including a program of study abroad approved for credit by the eligible institution at which such student is enrolled) leading to a recognized educational credential at an institution, and who is not enrolled in an elementary or secondary school.

(ii) *Tuition-paying*—(A) *In general*. For purposes of section 4968 and paragraph (a) of this section, the term *tuition-paying* means the payment of any tuition or fees required for the enrollment or attendance of a student for a course of instruction at an educational institution. The term *tuition-paying* does not include payment for supplies or equipment required during a specific course once a student is enrolled in and attending the course or the payment of room and board or other personal living expenses.

(B) *Treatment of a comprehensive or bundled fee*. If a student is required to pay a fee (such as a comprehensive fee or a bundled fee) to an educational institution that combines charges for tuition with charges for personal expenses such as room and board, the student is a tuition-paying student.

(C) *Scholarships and work study programs operated directly by the applicable educational institution*. Whether a student is tuition-paying is determined after taking into account any scholarships provided directly by the educational institution and any work study programs operated directly by the institution. Scholarship payments provided by third parties, even if administered by the institution, are considered payments of tuition on behalf of the student. Accordingly, a student will be considered a tuition-paying student if payment of tuition or a fee is required for the enrollment or attendance of the student for courses of instruction after the application of any scholarships offered directly by the institution or work study program operated directly by the institution.

(iii) *Located in the United States*. For purposes of section 4968 and paragraph (a) of this section, the term *located in the United States* refers to the location of a student. A student is considered to have been located in the United States if the student resided in the United States for at least a portion of the time the student attended the institution during the applicable educational institution's preceding taxable year.

(iv) *Full-time/part-time students*. For purposes of section 4968 and paragraph (a) of this section, the number of students of an educational institution (including for purposes of determining the number of students at a particular location) is based on the daily average number of full-time students attending such institution (with part-time students taken into account on a full-time student equivalent basis). The standards for determining part-time students, full-time students, full-time equivalents, and daily average are determined by each educational institution. However, the standards may not be lower than the applicable standards established by the Department of Education under the Higher Education Act of 1965 (20 U.S.C. 1088).

(4) *Assets used directly in carrying out an institution's exempt purpose*—(i) *In general*. For purposes of section 4968 and this paragraph (a)(4), an asset is used directly in carrying out an educational institution's exempt purpose only if the asset is actually used by the institution in carrying out its exempt purpose. Whether an asset is used directly by the institution to carry out its exempt purpose must be determined based on all the facts and circumstances. If property is used for an exempt purpose and for other purposes, and the exempt use represents 95 percent or more of the total use, the property is considered to be used exclusively for an exempt purpose. If the exempt use of such property represents less than 95 percent of the total use, the institution must make a reasonable allocation between such exempt and nonexempt uses.

(ii) *Illustrations*. Examples of assets that are used directly in carrying out an institution's exempt purpose include, but are not limited to, the following—

(A) Administrative assets, such as office equipment and supplies used by the institution directly in the administration of its exempt activities;

(B) Real estate or the portion of any building used by the institution directly in its exempt activities;

(C) Physical property such as paintings or other works of art owned by the institution which are on public display, fixtures and equipment in classrooms, research facilities and related equipment which under the facts and circumstances serve a useful purpose in the conduct of the institution's exempt activities;

(D) The reasonable cash balances necessary to cover current administrative expenses and other normal and current disbursements directly connected with the educational institution's exempt activities. For purposes of this paragraph (a)(4)(ii)(D), the portion of an educational institution's actual cash balances at the end of a year that does not exceed 1.5 percent of the fair market value of the institution's non-charitable use assets, determined without regard to any reduction for reasonable cash balances, will be deemed to be a reasonable cash balance; and

(E) Any property the educational institution leases to other persons at no cost (or at a nominal rent) to the lessee in furtherance of the institution's exempt purposes.

(iii) *Exceptions*. The following assets are examples of assets not used directly in carrying out an institution's exempt purpose—

(A) Assets that are held for the production of income or for investment (for example, stocks, bonds, interest-bearing notes, endowment funds, or leased real estate), even if the income from such assets is used to carry out such exempt purpose; and

(B) Property (such as offices) used for the purpose of managing the institution's endowment funds.

(iv) *Valuation of assets not used directly in carrying out an institution's exempt purpose*—(A) *In general*. The valuation of assets not used directly in carrying out an institution's exempt purpose is determined under the rules of section 4942(e) and §53.4942(a)-2(c)(4), as modified by paragraph (a)(4)(iv)(B) of this section.

(B) *Special rules*. In applying the rules of §53.4942(a)-2(c)(4), an educational institution must—

(*1*) Substitute "educational institution" for "private foundation" or "foundation" every place they appear; and

(*2*) Make such adjustments as are reasonable and necessary to obtain the fair market value of any and all assets as of the last day of the preceding taxable year, rather than any other times permitted or required by §53.4942(a)-2(c)(4).

(b) *Net investment income*—(1) *In general*. An applicable educational institution described in paragraph (a)(2) of this section is subject to the 1.4 percent tax on its net investment income, and, as described in paragraph (c) of this section, also on certain amounts of net investment income of certain related organizations, for the taxable year.

(2) *Calculation of net investment income*. For purposes of paragraph (b)(1) of this section, net investment income will be determined under the rules of section 4940(c) and §53.4940-1(c) through (f), as modified by paragraph (b)(3) of this section.

(3) *Special rules*. In applying §53.4940-1(c) through (f):

(i) Substitute "Applicable educational institution" for "private foundation" and "foundation" each place they appear.

(ii) Section 53.4940-1(d)(3), relating to certain distributions in redemption of stock, does not apply.

(iii) Substitute "December 31, 2017" for "December 31, 1969" each place it appears.

(iv) If an applicable educational institution held an interest in a partnership (including through one or more tiers of partnerships) on December 31, 2017, and continuously thereafter, and the partnership held assets on December 31, 2017 and continuously thereafter to the date of disposition, the partnership's basis in its assets with respect to the applicable educational institution for purposes of determining the applicable educational institution's share of gain upon sale or disposition of the assets is not less than the fair market value of such asset on December 31, 2017, plus or minus all adjustments as provided under §53.4940-1(f)(2)(i) after December 31, 2017, and before the date of disposition. To avail itself of this special partnership basis rule, an institution must obtain documentation from the partnership to substantiate the basis used.

(v) For purposes of §53.4940-1(f), overall net losses from sales or other dispositions of property by one related organization (or by the applicable educational institution) reduce (but not below zero) overall net gains from such sales or other dispositions by other related organizations (or by the applicable educational institution).

(c) *Related organizations*—(1) *Definition of related organization*—(i) *In general*. The term "related organization" means, with respect to an applicable educational institution, any organization which—

(A) Controls, or is controlled by, such institution;

(B) Is controlled by one or more persons which also control such institution; or

(C) Is a supported organization (as defined in section 509(f)(3)) or a supporting organization (as described in section 509(a)(3)) during the taxable year with respect to such institution.

(ii) *Control*. The term control generally means—

(A) *Stock corporation*. In the case of a corporation, ownership (by vote or value) of more than 50 percent of the stock of the corporation;

(B) *Partnership*. In the case of a partnership, ownership of more than 50 percent of the profits interests or capital interests in such partnership; or

(C) *Trust*. In the case of a trust with beneficial interests, ownership of more than 50 percent of the beneficial interests in the trust.

(D) *Nonstock organization*. In the case of a nonprofit organization or other organization without owners or persons having beneficial interests (nonstock organization), including a governmental entity, control means that—

(*1*) More than 50 percent of the directors or trustees of the applicable educational institution or nonstock organization are either representatives of, or are directly or indirectly controlled by, the other entity; or

(*2*) More than 50 percent of the directors or trustees of the nonstock organization are either representatives of, or are directly or indirectly controlled by, one or more persons that control the applicable educational institution. For purposes of this paragraph (c)(1)(ii)(D)(*2*), a "representative" means a trustee, director, agent, or employee, and control includes the power to remove a trustee or director and designate a new trustee or director.

(iii) *Constructive ownership*. The principles of section 318 apply for purposes of determining ownership of stock in a corporation, and similar principles apply for purposes of determining ownership of interest in any other entity.

(2) *Assets and net investment income of related organizations*—(i) *In general*. For purposes of determining the aggregate fair market value of the assets and net investment income of an educational institution, the assets and net investment income of any related organization are treated as the assets and net investment income, respectively, of the institution unless an exception provided in paragraph (c)(2)(ii) of this section applies.

(ii) *Exceptions*. For purposes of section 4968 and this paragraph (c)(2)—

(A) *No amount taken into account with respect to more than one educational institution*. In determining the aggregate fair market value of the assets and net investment income of an educational institution, assets and net investment income of a related organization are not taken into account with respect to more than one educational institution. Thus, in any case in which an organization is a related organization with respect to more than one educational institution, the assets and net investment income of the related organization must be allocated between the educational institutions being supported by the related organization. Such allocation must be made in a reasonable manner, taking into account all facts and circumstances, and must be used consistently across all related organizations.

(B) *Not intended or available for the use or benefit of the educational institution*—(*1*) *In general*. Except as provided by paragraph (c)(2)(ii)(B)(*3*) of this section, for purposes of determining the aggregate fair market value of the assets and net investment income of an educational institution, the assets and net investment income of a related organization are taken into account as assets and net investment income of the educational institution unless the assets and net investment are not intended or available for the use and benefit of the educational institution.

(*2*) *Determining whether assets and net investment income of a related organization are intended or available for the use and benefit of an educational institution*. Assets and net investment income of a related organization are intended or available for the use and benefit of an educational institution if such assets and net investment income are specifically earmarked or restricted for the benefit of, or are otherwise fairly attributable to, the educational institution. Conversely, assets and net investment income of a related organization are not intended or available for the use and benefit of an educational institution if such assets and net investment income are specifically earmarked or restricted for another entity or for unrelated purposes or are otherwise not fairly attributable to the educational institution. The assets and net investment income of a related organization must be allocated between those intended or available for the use and benefit of an educational institution and those not intended or not available for the use and benefit of an educational institution. Such allocation must be made in a reasonable manner, taking into account all facts and circumstances, and must be used consistently across all related organizations.

(*3*) *Organizations controlled by the institution or described in section 509(a)(3) with respect to the institution for the taxable year*—(*i*) *In general*. If a related organization is controlled, as defined in paragraph (c)(1) of this section, by an educational institution, or is a supporting organization described in section 509(a)(3) with respect to the educational institution, the assets and net investment income of the related organization are taken into account as assets and net investment income of the educational institution regardless of whether the assets and net investment income are earmarked or restricted for the benefit of, or otherwise fairly attributable to, the educational institution and even if they are specifically earmarked or restricted for another entity or for unrelated purposes or are otherwise not fairly attributable to the educational institution, subject to paragraph (c)(2)(ii)(A) of this section.

(*ii*) *Special rule for Type III supporting organizations with respect to such institution as of December 31, 2017*. An educational institution with a related organization that was a Type III supporting organization with respect to the educational institution on December 31, 2017, takes into account only the assets and net investment income of such Type III supporting organization that are intended or available for the use and benefit of, or otherwise fairly attributable to, the educational institution, as described in paragraph (c)(2)(ii)(B)(*2*) of this section. An educational institution may determine whether the assets and net investment income of such Type III supporting organization are intended or available for the use and benefit of, or otherwise fairly attributable to, the educational institution using any reasonable method. A method treating all the distributions received from such Type III supporting organization as net investment income of the school each year is deemed to be reasonable. Similarly, a method using the distributions received from the Type III supporting organization to calculate the percentage of the Type III supporting organization's total net income that was distributed to the educational institution, and then using the same percentage to calculate the value of the underlying assets of the Type III supporting organization that are intended or available for the use and benefit of the educational institution each year, will be deemed to be reasonable.

(d) *Applicability date*. The rules of this section apply to taxable years beginning after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**. A taxpayer may rely on these regulations for taxable years beginning before publication of final regulations.

Kirsten Wielobob,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on June 28, 2019, 4:15 p.m. and published in the issue of the Federal Register for July 3, 2019, 84 F.R. 31795)

Multiple Employer Plans

REG-121508-18

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document sets forth proposed regulations relating to the tax qualification of plans maintained by more than one employer. These plans, maintained pursuant to section 413(c) of the Internal Revenue Code (Code), are often referred to as multiple employer plans or MEPs. The proposed regulations would provide an exception, if certain requirements are met, to the application of the "unified plan rule" for a defined contribution MEP in the event of a failure by an employer participating in the plan to satisfy a qualification requirement or to provide information needed to determine compliance with a qualification requirement. These proposed regulations would affect MEPs, participants in MEPs (and their beneficiaries), employers participating in MEPs, and MEP plan administrators.

DATES: Comments and requests for a public hearing must be received by October 1, 2019.

ADDRESSES: Submit electronic submissions via the Federal eRulemaking Portal at *www.regulations.gov* (indicate IRS and REG-121508-18) by following the online instructions for submitting comments. Once submitted to the Federal eRulemaking Portal, comments cannot be edited or withdrawn. The Department of the Treasury (Treasury Department) and the IRS will publish for public availability any comment received to its public docket, whether submitted electronically or in hard copy. Send hard copy submissions to: CC:PA:LPD:PR (REG-121508-18), Room 5203, 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-121508-18), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW, Washington, DC 20224.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Pamela Kinard at (202) 317-6000 or Jamie Dvoretzky at (202) 317-4102; concerning submission of comments or to request a public hearing, email or call Regina Johnson at notice.comments@irscounsel.treas.gov, (202) 317-5190, or (202) 317-6901 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document sets forth proposed amendments to the Income Tax Regulations (26 CFR part 1) under section 413(c) of the Internal Revenue Code (Code). Section 413(c) provides rules for the qualification of a plan maintained by more than one employer.[1] A section 413(c) plan is often referred to as a multiple employer plan (MEP).

Final regulations under section 413 were published in the **Federal Register** on November 9, 1979, 44 FR 65061 (the final section 413 regulations). The final section 413 regulations apply to multiple employer plans described in section 413(c) and to collectively bargained plans described in section 413(b) (plans that are maintained pursuant to certain collective-bargaining agreements between employee representatives and one or more employers).

Pursuant to section 413(c) and the final section 413 regulations, all of the employers maintaining a MEP (participating employers) are treated as a single employer for purposes of certain section 401(a) qualification requirements. For example:

- Under section 413(c)(1) and §1.413-2(b), the rules for participation under section 410(a) and the regulations thereunder are applied as if all employees of each of the employers who maintain the plan are employed by a single employer;
- Under section 413(c)(2) and §1.413-2(c), in determining whether a MEP is, with respect to each participating employer, for the exclusive benefit of its employees (and their beneficiaries), all of the employees participating in the plan are treated as employees of each such employer; and
- Under section 413(c)(3) and §1.413-2(d), the minimum vesting standards under section 411 are applied as if all employers who maintain the plan constitute a single employer.

Other rules are applied separately to each participating employer.[2] For example, under §1.413-2(a)(3)(ii), the minimum coverage requirements of section 410(b) generally are applied to a MEP on an employer-by-employer basis.

A plan is not described in section 413(c) unless it is maintained by more than one employer[3] and is a single plan under section 414(l).[4] *See* §§1.413-2(a)(2)(i) and 1.413-1(a)(2). Under §1.414(l)-1(b), a plan is a single plan if and only if, on an ongoing basis, all of the plan assets are available to pay benefits to employees who are covered by the plan and their beneficiaries.

Under §1.413-2(a)(3)(iv) (sometimes referred to as the "unified plan rule"), the qualification of a MEP is determined with respect to all employers maintaining the MEP. Consequently, §1.413-2(a)(3)(iv) provides that "the failure by one employer maintaining the plan (or by the plan itself) to satisfy an applicable qualification requirement will result in the disqualification of the MEP for all employers maintaining the plan." Section 1.416-1, Q&A G-2, includes a similar rule relating to the qualification of a MEP, providing that a failure by a MEP to satisfy section 416 with respect to employees of one participating employer means that all participating employers in the MEP are maintaining a plan that is not a qualified plan.[5]

Section 1101(a) of the Pension Protection Act of 2006 (PPA '06), Public Law 109-280 (120 Stat. 780 (2006)), provides that the Secretary has full authority to establish and implement EPCRS[6] (or any successor program) and any other employee plans correction policies, including the authority to waive income, excise, or other taxes to ensure that any tax, penalty, or sanction is not excessive and bears a reasonable relationship to the nature, extent, and severity of the failure. Section 1101(b) of PPA '06 provides that the Secretary shall continue to update and improve EPCRS (or any successor program),

[1] Section 210 of the Employee Retirement Income Security Act of 1974, Public Law 93-406 (88 Stat. 829 (1974)), as amended (ERISA), also provides rules relating to plans maintained by more than one employer. Similar to section 413(c) of the Code, section 210(a) of ERISA states that the minimum participation standards, minimum vesting standards, and benefit accrual requirements under sections 202, 203, and 204 of ERISA, respectively, shall be applied as if all employees of each of the employers were employed by a single employer. Under section 101 of Reorganization Plan No. 4 of 1978 (43 FR 47713), the Secretary of the Treasury has interpretive jurisdiction over section 413 of the Code, as well as ERISA section 210.

[2] Proposed rules at §1.413-2(e) and (f) (47 FR 54093) were issued in 1982. Proposed §1.413-2(e) would have provided that the minimum funding standard for a MEP is determined as if all participants in the plan were employed by a single employer, and proposed §1.413-2(f) would have provided rules relating to liability for the excise tax on a failure to meet the minimum funding standards. Because these rules were proposed in 1982, they do not reflect 1988 changes to section 413(c)(4) that were made by section 6058(a) of the Technical and Miscellaneous Revenue Act of 1988, Public Law 100-647 (102 Stat. 3342) (TAMRA). As amended by TAMRA, section 413(c)(4) generally provides that in the case of a plan established after December 31, 1988, and in the case of a plan established before that date for which an election was made, each employer is treated as maintaining a separate plan for purposes of the minimum funding standards. The proposed rules at §1.413-2(e) and (f) are outside the scope of these proposed regulations. Therefore, paragraphs (e) and (f) are "Reserved" for future rulemaking. The Treasury Department and the IRS note that taxpayers must take into account the statutory changes made after the issuance of the proposed regulations as of the effective dates of the relevant legislation.

[3] Section 1.413-2(a)(2), issued in 1979, provides that for purposes of determining the number of employers maintaining a plan, any employers described in section 414(b) that are members of a controlled group of corporations or any employers described in section 414(c) that are trades or businesses under common control, whichever is applicable, are treated as if those employers are a single employer. Because §1.413-2(a)(2) was issued in 1979, it does not address section 414(m), which was added in 1980 by section 201(a) of the Miscellaneous Revenue Act of 1980, Public Law 96-605 (94 Stat. 3521). Section 414(m) provides that all employers in an affiliated service group shall be treated as a single employer. Although amendments to §1.413-2(a)(2) are outside the scope of these proposed regulations, the Treasury Department and the IRS note that taxpayers must take into account the statutory changes made after the issuance of the proposed regulations as of the effective dates of the relevant legislation.

[4] On October 23, 2018, proposed Department of Labor regulations were published in the **Federal Register** (83 FR 53534) clarifying the circumstances in which employer groups or associations and professional employer organizations can constitute "employers" within the meaning of section 3(5) of ERISA for purposes of establishing or maintaining an individual account "employee pension benefit plan" within the meaning of ERISA section 3(2). Those proposed regulations state that an "employee pension benefit plan" under section 3(2) of ERISA must be established by an "employer," defined in section 3(5) of ERISA to include an "entity acting indirectly in the interest of an employer in relation to an employee benefit plan." The proposed Department of Labor regulations define the terms "bona fide group or association of employers" and "bona fide professional employer organization" and state that, with respect to a "multiple employer defined contribution pension plan," these entities "shall be deemed to be able to act in the interest of an employer" provided that certain conditions are met. *See* proposed rules at 29 CFR 2510.3-55(a). The proposed Department of Labor regulations solicit comments on, but do not address, other types of entities that may be an employer under ERISA section 3(5).

[5] This rule is based on the unified plan rule in §1.413-2(a)(3)(iv). Therefore, if a defined contribution MEP has an unresponsive employer that fails to satisfy section 416 and the defined contribution MEP meets the conditions for the exception to the unified plan rule in these proposed regulations, the defined contribution MEP will not be disqualified for the section 416 failure. For further information, see the discussion in part II of the Explanation of Provisions section entitled *Conditions for Application of Exception to the Unified Plan Rule*. The rules in §1.416-1 are outside the scope of these proposed regulations, but the Treasury Department and the IRS intend to address the topic in a broader guidance project updating the regulations under section 416.

[6] The Employee Plans Compliance Resolution System (EPCRS) is a comprehensive system of correction programs for sponsors of certain retirement plans, including plans that are intended to satisfy the qualification requirements of section 401(a). EPCRS provides procedures for an employer to correct a plan's failure to satisfy an applicable qualification requirement so that the failure does not result in disqualification of the plan.

giving special attention to a number of items, including special concerns and circumstances that small employers face with respect to compliance and correction of compliance failures. EPCRS has been updated and expanded several times, most recently in Rev. Proc. 2019-19, 2019-19 I.R.B. 1086. In addition, as provided for in Section 1101 of PPA '06, the Treasury Department and the IRS are authorized to establish and implement other employee plans correction policies, outside of EPCRS.

On August 31, 2018, President Trump issued Executive Order 13847 (83 FR 45321 (Sept. 6, 2018)), titled "Strengthening Retirement Security in America" (Executive Order). The Executive Order states that it shall be the policy of the Federal Government to expand access to workplace retirement plans for American workers and that enhancing workplace retirement plan coverage is critical to ensuring that American workers will be financially prepared to retire. The Executive Order also states that, "[e]xpanding access to [MEPs], under which employees of different private-sector employers may participate in a single retirement plan, is an efficient way to reduce administrative costs of retirement plan establishment and maintenance and would encourage more plan formation and broader availability of workplace retirement plans, especially among small employers."[7]

The Executive Order directs the Secretary of the Treasury to "consider proposing amendments to regulations or other guidance, consistent with applicable law and the policy set forth in … this order, regarding the circumstances under which a MEP may satisfy the tax qualification requirements …, including the consequences if one or more employers that sponsored or adopted the plan fails to take one or more actions necessary to meet those requirements."[8] The Executive Order further directs the Secretary of the Treasury to consult with the Secretary of Labor in advance of issuing any such proposed guidance, and the Secretary of Labor to take steps to facilitate the implementation of any guidance, as appropriate and consistent with applicable law.

Stakeholders have expressed concerns about the risk that the actions of one or more participating employers might disqualify a MEP[9] and that some employers are reluctant to join MEPs without an exception to the unified plan rule. In particular, they have said that the cooperation of participating employers is needed for compliance and when a participating employer refuses to take the steps needed to maintain qualification, the entire plan is at risk of being disqualified. Stakeholders assert that without an exception to the unified plan rule, many employers perceive that the benefits of joining a MEP are outweighed by the risk of plan disqualification based on the actions of an uncooperative participating employer.

Explanation of Provisions

I. *Overview*

In accordance with the Executive Order and the policy of expanding workplace retirement plan coverage, these proposed regulations, which were developed in consultation with the Secretary of Labor, would provide an exception to the unified plan rule for certain defined contribution MEPs. Under the proposed regulations, a defined contribution MEP would be eligible for the exception to the unified plan rule on account of certain qualification failures due to actions or inaction by a participating employer, if the conditions set forth in the proposed regulations are satisfied. The exception generally would be available if the participating employer in a MEP is responsible for a qualification failure that the employer is unable or unwilling to correct. It would also be available if the participating employer fails to comply with the section 413(c) plan administrator's request for information about a qualification failure that the section 413(c) plan administrator reasonably believes might exist. For the exception to the unified plan rule to apply, certain actions are required to be taken, including, in certain circumstances, a spinoff of the assets and account balances attributable to participants who are employees of such an employer to a separate plan and a termination of that plan.

For purposes of applying the exception to the unified plan rule, under the proposed regulations: (1) a section 413(c) plan administrator is defined as the plan administrator of a MEP, determined under the rules of section 414(g); (2) a participating employer is defined as one of the employers maintaining a MEP; (3) an unresponsive participating employer is defined as a participating employer in a MEP that fails to comply with reasonable and timely requests from the section 413(c) plan administrator for information necessary to determine compliance with a qualification requirement or fails to comply with reasonable and timely requests from the section 413(c) plan administrator to take actions that are needed to correct a failure to satisfy a qualification requirement as it relates to the participating employer; and (4) an employee is defined as a current or former employee of a participating employer.

The exception to the unified plan rule would apply only in the case of certain types of failures to satisfy the qualification requirements, referred to in the proposed regulations as participating employer failures. A participating employer failure is defined as either a known qualification failure or a potential qualification failure. A known qualification failure is defined as a failure to satisfy a qualification requirement with respect to a MEP that is identified by the section 413(c) plan administrator and is attributable solely to an unresponsive participating employer. A potential qualification failure is a failure to satisfy a qualification requirement with respect to a MEP that the section 413(c) plan administrator reasonably believes might exist, but the section 413(c) plan administrator is unable to determine whether the qualification requirement is satisfied solely due to an unresponsive

[7] *Id*. at 45321.
[8] *Id*. at 45322.
[9] *See also*, U.S. Gov't Accountability Office, GAO-12-665, "Federal Agencies Should Collect Data and Coordinate Oversight of Multiple Employer Plans" (September 2012) (*https://www.gao.gov/assets/650/648285.pdf*) (identifying the unified plan rule as a potential problem for MEPs).

participating employer's failure to provide data, documents, or any other information necessary to determine whether the MEP is in compliance with the qualification requirement as it relates to the participating employer. For purposes of the definitions of known qualification failure and potential qualification failure, an unresponsive participating employer includes any employer that is treated as a single employer with that unresponsive participating employer under section 414(b), (c), (m), or (o).

II. *Conditions for Application of Exception to Unified Plan Rule*

Under the exception to the unified plan rule in the proposed regulations, a defined contribution MEP would not be disqualified on account of a participating employer failure, provided that the following conditions are satisfied: (1) the MEP satisfies certain eligibility requirements (such as a requirement to have established practices and procedures to promote compliance and a requirement to adopt relevant plan language); (2) the section 413(c) plan administrator provides notice and an opportunity for the unresponsive participating employer to take remedial action with respect to the participating employer failure; (3) if the unresponsive participating employer fails to take appropriate remedial action with respect to the participating employer failure, the section 413(c) plan administrator implements a spinoff; and (4) the section 413(c) plan administrator complies with any information request that the IRS or a representative of the spun-off plan makes in connection with an IRS examination of the spun-off plan, including any information request related to the participation of the unresponsive participating employer in the MEP for years prior to the spinoff. A spinoff may either be a spinoff that is initiated by the unresponsive participating employer and implemented by the section 413(c) plan administrator, or a spinoff-termination implemented by the section 413(c) plan administrator pursuant to plan terms.

A. *MEP's Eligibility for Exception to the Unified Plan Rule*

Under the proposed regulations, a threshold condition for the exception to the unified plan rule is that the MEP meet certain eligibility requirements. Specifically, the proposed regulations would require the section 413(c) plan administrator to have established practices and procedures (formal or informal) that are reasonably designed to promote and facilitate overall compliance with applicable Code requirements, including procedures for obtaining information from participating employers. In addition, the plan document would need to include language describing the procedures that would be followed to address participating employer failures, including the procedures that the section 413(c) plan administrator would follow if, after receiving notice from the section 413(c) plan administrator, an unresponsive participating employer fails to take appropriate remedial action or to initiate a spinoff from the MEP pursuant to the regulations.[10] Finally, a MEP is not eligible for the exception to the unified plan rule if, as of the date that the first notice is provided to an unresponsive participating employer, the MEP is under examination. For a description of the first notice, see part II.B. of this Explanation of Provisions section, entitled *Notice Requirements*.

For purposes of the proposed regulations, a plan is under examination if: (1) the plan is under an Employee Plans examination (that is, an examination of a Form 5500 series, "Annual Return/Report of Employee Benefit Plan," or other examination by the Employee Plans Office of the Tax Exempt and Government Entities Division of the IRS (Employee Plans) (or any successor IRS office that has jurisdiction over qualified retirement plans)); (2) the plan is under investigation by the Criminal Investigation Division of the IRS (or its successor); or (3) the plan is treated as under an Employee Plans examination under special rules. Under these special rules, for example, a plan is under an Employee Plans examination if the section 413(c) plan administrator, or an authorized representative, has received verbal or written notification of an impending Employee Plans examination, or of an impending referral for an Employee Plans examination, or if a plan has been under an Employee Plans examination and the plan has an appeal pending with the IRS Office of Appeals (or its successor), or is in litigation with the IRS, regarding issues raised in the Employee Plans examination.

This definition of the term under examination is similar to the definition in EPCRS. *See* Rev. Proc. 2019-19, section 5.08. However, unlike in EPCRS, a plan is not under examination for purposes of these proposed regulations merely because it is maintained by an employer that is under an Exempt Organizations examination (that is, an examination of a Form 990 series or other examination by the Exempt Organizations Office of the Tax Exempt and Government Entities Division of the IRS).

B. *Notice Requirements*

The proposed regulations would require the section 413(c) plan administrator to provide up to three notices regarding a participating employer failure to the unresponsive participating employer; with the third notice, if applicable, also being provided to participants and beneficiaries and the Department of Labor.[11]

The first notice must describe the participating employer failure (or failures), as well as the remedial actions the unresponsive participating employer would need to take to remedy the failure and the employer's option to initiate a spinoff. The first notice must also explain the consequences under plan terms if the unresponsive participating employer neither takes appropriate remedial action with respect to the participating employer failure nor initiates a spinoff, including the possibility that a spinoff of the plan assets and account balances attributable to the employees of that employer into a separate single-employer plan would occur, followed by a termination of that plan (as discussed in this preamble under the heading *Spinoff-Termination*).

[10] Once final regulations are issued, the Treasury Department and the IRS intend to publish guidance in the Internal Revenue Bulletin setting forth model language that may be used for this purpose.

[11] If the notices relate to a potential qualification failure, and the potential qualification failure becomes a known qualification failure, then a new series of notices may be required.

If, by the end of the 90-day period following the date the first notice is provided, the unresponsive participating employer neither takes appropriate remedial action nor initiates a spinoff, then no later than 30 days after the expiration of that 90-day period, the section 413(c) plan administrator must provide a second notice to that employer. The second notice must include the information required to be included in the first notice, and must also inform the employer that if it fails either to take appropriate remedial action or to initiate a spinoff within 90 days after the second notice then a notice describing the participating employer failure and the consequences of not correcting that failure will be provided to participants who are employees of the unresponsive participating employer (and their beneficiaries) and to the Department of Labor.

If, by the end of the 90-day period following the date the second notice is provided, the unresponsive participating employer neither takes appropriate remedial action nor initiates a spinoff, then no later than 30 days after the expiration of that 90-day period, the section 413(c) plan administrator must provide a third notice to the unresponsive participating employer, to participants who are employees of that employer (and their beneficiaries), and to the Department of Labor.[12] The third notice must include the information required to be included in the first notice, the deadline for employer action, and an explanation of any adverse consequences to participants in the event that a spinoff-termination occurs, and state that the notice is being provided to participants who are employees of the unresponsive participating employer (and their beneficiaries) and to the Department of Labor.

C. *Actions by Unresponsive Participating Employer*

The proposed regulations provide that after the unresponsive participating employer has received notice of the participating employer failure, the employer has the opportunity to either take appropriate remedial action or initiate a spinoff. The final deadline for an unresponsive participating employer to take one of these actions is 90 days after the third notice is provided. The consequences of the employer's failure to meet this deadline are described in this Explanation of Provisions section under part II.E., entitled *Spinoff-Termination*.

The proposed regulations provide that an unresponsive participating employer takes appropriate remedial action with respect to a potential qualification failure if the employer provides data, documents, or any other information necessary for the section 413(c) plan administrator to determine whether a qualification failure exists. If (1) the unresponsive participating employer provides this information, (2) the section 413(c) plan administrator determines that, based on this information, a qualification failure exists that is attributable solely to that employer, and (3) the participating employer fails to comply with reasonable and timely requests from the section 413(c) plan administrator to take actions that are needed to correct that qualification failure, then the qualification failure becomes a known qualification failure. In that case, the MEP would be eligible for the exception to the unified plan rule with respect to the known qualification failure by satisfying the conditions with respect to that known qualification failure, taking into account the rules described in this Explanation of Provisions section under part II.D., entitled *Actions by Section 413(c) Plan Administrator Relating to Remedial Action or Employer-Initiated Spinoff*. An unresponsive participating employer takes appropriate remedial action with respect to a known qualification failure if the employer takes action, such as making corrective contributions, that corrects, or enables the section 413(c) plan administrator to correct, the known qualification failure.

As an alternative to taking appropriate remedial action with respect to a potential or a known qualification failure, an unresponsive participating employer may, after receiving notice of the participating employer failure, initiate a spinoff by directing the section 413(c) plan administrator to spin off plan assets and account balances held on behalf of employees of that employer to a separate single-employer plan established and maintained by that employer in a manner consistent with plan terms. In that case, the section 413(c) plan administrator must implement that spinoff, as described in this Explanation of Provisions section under part II.D., entitled *Actions by Section 413(c) Plan Administrator Relating to Remedial Action or Employer-Initiated Spinoff*.

D. *Actions by Section 413(c) Plan Administrator Relating to Remedial Action or Employer-Initiated Spinoff*

For purposes of applying the conditions of the exception to the unified plan rule to a potential qualification failure that becomes a known qualification failure, actions taken (including notices provided) when the failure was a potential qualification failure are not taken into account. For example, a notice that the section 413(c) plan administrator provided in connection with the potential qualification failure would not satisfy the notice requirements for the known qualification failure. However, in determining whether the MEP is under examination as of the date of the first notice describing the known qualification failure, the section 413(c) plan administrator will be treated as providing that notice on the date the first notice was provided with respect to the related potential qualification failure, but only if the following conditions are satisfied: (1) after determining that a qualification failure exists, the section 413(c) plan administrator makes a reasonable and timely request to the participating employer to take actions that are needed to correct the failure, and (2) as soon as reasonably practicable after the participating employer fails to respond to that request, the section 413(c) plan administrator provides the first notice with respect to the known qualification failure.

The Treasury Department and the IRS anticipate revising EPCRS to provide that, if a section 413(c) plan administrator provides the first notice with respect to a participating employer failure under a MEP

[12] The notice to the Department of Labor should be mailed to the Employee Benefits Security Administration's Office of Enforcement (or its successor office). The Office of Enforcement is currently located at 200 Constitution Ave., NW, Suite 600, Washington, DC 20210.

at a time that the plan is not under examination, then the MEP will not be considered to be under examination for purposes of determining whether the participating employer failure is eligible to be corrected under the Self Correction Program or Voluntary Correction Program components of EPCRS. It is anticipated that this application of the term under examination under EPCRS will be conditioned on the section 413(c) plan administrator complying with applicable conditions for the exception to the unified plan rule and, for a known qualification failure with respect to which the unresponsive participating employer takes appropriate remedial action, taking any remaining action necessary to correct the qualification failure as soon as reasonably practicable.

If an unresponsive participating employer takes appropriate remedial action with respect to a known qualification failure, then the section 413(c) plan administrator must take any remaining action necessary to correct the qualification failure. If the section 413(c) plan administrator fails to take any remaining action necessary to correct the known qualification failure, the exception to the unified plan rule will not apply and the section 413(c) plan may be disqualified on account of that failure.

If, instead of taking appropriate remedial action (as described in part II.C. of this Explanation of Provisions, entitled *Actions by Unresponsive Participating Employer*), an unresponsive participating employer initiates a spinoff of plan assets and account balances held on behalf of employees of that employer to a separate single-employer plan established and maintained by that employer, the section 413(c) plan administrator must implement and complete a spinoff of the plan assets and account balances held on behalf of the employees of the employer that are attributable to employment by the employer within 180 days of the date on which it was initiated. The section 413(c) plan administrator must also report the spinoff to the IRS (in the manner prescribed by the IRS in forms, instructions, and other guidance).

E. *Spinoff-Termination*

If, after the first notice of a participating employer failure is provided, the unresponsive participating employer neither takes appropriate remedial action nor initiates a spinoff by the date that is 90 days after the third notice is provided, then, for the exception to the unified plan rule to apply, there must be a spinoff of the plan assets and account balances held on behalf of employees of the unresponsive participating employer that are attributable to their employment with that employer to a separate plan, followed by a termination of that plan. The spinoff-termination must be pursuant to plan terms and in accordance with the proposed regulations. The MEP will satisfy this condition, if, as soon as reasonably practicable after the deadline for action by the unresponsive participating employer, the section 413(c) plan administrator: (1) provides notice of the spinoff-termination to participants who are employees of the unresponsive participating employer (and their beneficiaries); (2) stops accepting contributions from the unresponsive participating employer; (3) implements a spinoff, in accordance with the transfer requirements of section 414(l) and the anti-cutback requirements of section 411(d)(6), of the plan assets and account balances held on behalf of employees of the unresponsive participating employer that are attributable to their employment by that employer to a separate single-employer plan and trust that has the same plan administrator, trustee, and substantive plan terms as the MEP; and (4) terminates the spun-off plan and distributes assets of the spun-off plan to plan participants and beneficiaries as soon as reasonably practicable after the plan termination date.[13]

In terminating the spun-off plan, the section 413(c) plan administrator must:

- Reasonably determine whether, and to what extent, the survivor annuity requirements of sections 401(a)(11) and 417 apply to any benefit payable under the plan and take reasonable steps to comply with those requirements (if applicable);
- Provide each participant and beneficiary with a nonforfeitable right to his or her accrued benefits as of the date of plan termination, subject to income, expenses, gains, and losses between that date and the date of distribution; and
- Notify the participants and beneficiaries of their rights under section 402(f).

In providing notice of the spinoff-termination to participants (and their beneficiaries), the section 413(c) plan administrator must provide information relating to the spinoff-termination to participants who are employees of the unresponsive participating employer (and their beneficiaries), including the following: (1) identification of the MEP and contact information for the section 413(c) plan administrator; (2) the effective date of the spinoff-termination; (3) a statement that no more contributions will be made to the MEP; (4) a statement that as soon as practicable after the spinoff-termination, participants and beneficiaries will receive a distribution from the spun-off plan; and (5) a statement that before the distribution occurs, participants and beneficiaries will receive additional information about their options with respect to that distribution.

The section 413(c) plan administrator must report the spinoff-termination to the IRS (in the manner prescribed by the IRS in forms, instructions, and other guidance).

III. *Other Rules*

A. *Form of Notices*

Any notices required to be provided under the proposed regulations may be provided in writing or in electronic form. For notices provided to participants and beneficiaries, see generally §1.401(a)-21 for rules permitting the use of electronic

[13] The Pension Benefit Guaranty Corporation's Missing Participants Program provides a mechanism for distributing assets to plan participants in a terminating plan. *See* 29 CFR 4050.201 through 4050.207. Use of the Pension Benefit Guaranty Corporation's Missing Participants Program is optional for defined contribution plans. Under the program, the Pension Benefit Guaranty Corporation locates participants and beneficiaries who were missing when their plans terminated. When found, depending on arrangements made by the plan, the Pension Benefit Guaranty Corporation either provides the benefit or information about where the participant's account is being held.

media to provide applicable notices to recipients with respect to retirement plans.

B. *Qualification of Spun-Off Plan*

In the case of any plan that is spun off in accordance with the proposed regulations, any participating employer failure that would have affected the qualification of a MEP, but for the application of the exception to the unified plan rule, will be a qualification failure with respect to the spun-off plan. In the case of an employer-initiated spinoff, see EPCRS (or its successors) for rules relating to correcting qualification failures.

Under the authority provided by section 1101 of PPA '06, the proposed regulations provide that distributions made from a spun-off plan that is terminated in accordance with these regulations would not, solely because of the participating employer failure, fail to be eligible for favorable tax treatment accorded to distributions from qualified plans (including that the distributions will be treated as eligible rollover distributions under section 402(c)(4)), except as provided in the next paragraph. Under section 1101 of PPA '06, Congress gave the Secretary broad authority to establish employee plans correction policies. In developing a correction policy for MEPs, it is appropriate to treat distributions to rank-and-file participants following a spinoff-termination as eligible for tax-favored treatment in order to ensure that the tax or sanction is not excessive and bears a reasonable relationship to the nature of the failure.[14]

The regulations also provide that, notwithstanding the general rule regarding favorable tax treatment for distributions from a plan following spinoff-termination, the IRS reserves the right to pursue appropriate remedies under the Code against any party (such as the owner of the participating employer) who is responsible for the participating employer failure resulting in the spinoff-termination. The IRS may pursue appropriate remedies against a responsible party even in the party's capacity as a participant or beneficiary under the plan that is spun off and terminated (such as by not treating a plan distribution made to the responsible party as an eligible rollover distribution). This is similar to the approach adopted in EPCRS with respect to terminating orphan plans. *See* Rev. Proc. 2019-19, section 6.02(2)(e)(i).

The proposed regulations also provide that the Commissioner may provide additional guidance, such as in revenue rulings, notices, or other guidance published in the Internal Revenue Bulletin, or in forms and instructions, that the Commissioner determines to be necessary or appropriate with respect to the requirements of the regulations.

Proposed Applicability Date

These regulations generally are proposed to apply on or after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**. Until regulations finalizing these proposed regulations are issued, taxpayers may not rely on the rules set forth in these proposed regulations.

Availability of IRS Documents

For copies of recently issued revenue procedures, revenue rulings, notices and other guidance published in the Internal Revenue Bulletin, please visit the IRS website at *www.irs.gov* or contact the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402.

Special Analyses

I. *Regulatory Impact Analysis*

Executive Orders 13771, 13563, and 12866 direct agencies to assess costs and benefits of available regulatory alternatives and, if regulation is necessary, to select regulatory approaches that maximize net benefits, including potential economic, environmental, public health and safety effects, distributive impacts, and equity. Executive Order 13563 emphasizes the importance of quantifying both costs and benefits, reducing costs, harmonizing rules, and promoting flexibility. The Executive Order 13771 designation for any final rule resulting from the proposed regulation will be informed by comments received. The preliminary Executive Order 13771 designation for this proposed rule is deregulatory.

The proposed regulation has been designated by the Office of Information and Regulatory Affairs (OIRA) as significant under Executive Order 12866 pursuant to the Memorandum of Agreement (MOA, April 11, 2018) between the Treasury Department and the Office of Management and Budget regarding review of tax regulations.

1. *Introduction and Need for Regulation*

The U.S. retirement system is comprised of three main pillars of savings: Social Security, workplace pension plans, and individual savings. Yet, roughly 30% of American workers lack access to an employer-sponsored savings vehicle (See Table 1 in Section 7 of this Regulatory Impact Analysis, entitled *Tables*). This is particularly true for employees at small firms, who are roughly half as likely to have access to a retirement plan compared to employees at large firms. This would lead to larger firms enjoying a competitive advantage in labor markets. One factor that may prevent small firms from offering a plan includes the high administrative costs associated with compliance. In order to receive preferential tax treatment, a plan must meet certain criteria specified in the Code and ensuring that those requirements are met can be costly. Furthermore, the costs associated with managing funds in retirement plans tends to be higher for a smaller pool of assets (See Table 3 in Section 7, later), which is more likely to be the case for smaller firms with fewer employees.

One solution that has developed for reducing these administrative and asset management costs is the MEP, through which different employers can form a single plan to take advantage of economies of scale. Under the current regulations under section 413(c), however, the unified plan rule creates a situation whereby should one employer fail to comply with the qualification requirements, then the preferen-

[14] In addition, a participating employer failure could either be a known qualification failure or a potential qualification failure. Treating distributions from a spun-off and terminated plan relating to a potential qualification failure as ineligible for tax-favored treatment does not bear a reasonable relationship to the nature of the failure.

tial tax status for a qualified plan is lost for the entire MEP. The proposed regulation provides an exception to the unified plan rule for certain defined contribution MEPs, permitting compliant participating employers to continue to maintain a qualified plan if certain conditions are satisfied. Reducing the perceived risk that a MEP will be disqualified could lead to more small employers adopting these plans.

2. *Affected Entities*

Based on the latest available data, as shown in Table 2, there are about 4,630 defined contribution MEPs with approximately 4.4 million total participants, 3.7 million of whom are active participants. Defined contribution MEPs hold about $181 billion in assets. Fifty-six percent of defined contribution MEP participants are in MEPs with 10,000 or more participants, and 98% are in MEPs with 100 or more participants. As noted earlier, about 30% of employees do not have access to a retirement savings plan through their employer. The proposed regulation, which is limited to defined contribution MEPs, may encourage both the creation of new defined contribution MEPs and the expansion of existing defined contribution MEPs. As a result of the proposed regulation, the cost of providing some existing employer-sponsored retirement plans could fall, and some employees would gain access to employer-sponsored retirement plans.

3. *Baseline*

The analysis in this section compares the proposed regulation to a no-action baseline reflecting anticipated Federal income tax-related behavior in the absence of these proposed regulations.

4. *Benefits*

a. *Expanded Access to Coverage*

Generally, employees rarely choose to save for retirement outside of the workplace, despite having options to save in tax-favored savings vehicles on their own; only about 10% of households without access to an employer-sponsored plan made contributions to traditional or Roth IRAs for 2014.[15] Thus, the availability of workplace retirement plans is a significant factor affecting whether individuals save for their retirement. Yet, despite the advantages of workplace retirements plans, access to such plans for employees of small businesses is relatively low.

The MEP structure may address significant concerns from employers about the costs to set up and administer retirement benefit plans. In order to participate in a MEP, employers would simply execute a participation agreement or similar instrument setting forth the rights and obligations of the MEP and participating employers. Each participating employer would then be participating in a single plan, rather than sponsoring its own separate plan. The individual employers would not be directly responsible for the MEP's overall compliance with reporting and disclosure obligations. Accordingly, the MEP structure may address small employers' concerns regarding the cost associated with fiduciary liability of sponsoring a retirement plan by effectively transferring much of the legal risks and responsibilities to professional fiduciaries who would be responsible for managing plan assets and selecting investment menu options, among other things. Participating employers' continuing involvement in the day-to-day operations and administration of their MEP generally would be limited to enrolling employees and forwarding employee and employer contributions to the plan. Thus, participating employers would keep more of their day-to-day focus on managing their businesses, rather than their retirement plans.

The proposed regulation would reduce the risk to small businesses participating in a MEP. Currently, if one participating employer fails to meet the qualification requirements in the Code for preferential tax treatment, then the entire plan may be disqualified, and employers participating in a MEP and their employees would lose the tax benefits of participating in a qualified retirement plan (deduction for contributions, exclusion of investment returns, deferred income recognition for employees). As a result, the current rule imposes an undue burden on employers who satisfied their requirements but happened to have a bad actor among their plan's other employers. The proposed regulation minimizes this burden by allowing noncompliant or unresponsive participating employers to be dealt with separately while the other participating employers maintain a qualified plan. Thus, the risk taken on by any one participating employer when joining a MEP is reduced as the employer no longer needs to consider the actions of other participating employers over which the employer exerts no control. The proposed regulation may therefore encourage formation of additional MEPs, as well as expanded participation in existing MEPs.

Because more plan formation and broader availability of such plans is likely to occur due to the proposed regulations, especially among small employers, the Treasury Department has determined that the proposed regulation would increase access to retirement plans for many American workers. However, the Treasury Department does not have sufficient data to determine precisely the likely extent of increased participation by small employers under the proposed regulation.

b. *Reduced Fees and Administration Savings*

Most MEPs could be expected to benefit from scale advantages that small businesses do not currently enjoy and to pass on some of the savings to participating employers and employees. Grouping small employers together into a MEP may facilitate savings through administrative efficiencies (economies of scale) and potentially through price negotiation (market power).

As scale increases, MEPs would spread fixed costs over a larger pool of participating employers and employee participants. Scale efficiencies can be very large with respect to asset management and may be smaller, but still meaningful, with respect to recordkeeping. Also, as scale increases, so does the negotiating power of MEPs. Negotiating power matters when competi-

[15] Based on tabulations from the Office of Tax Analysis' microsimulation model.

tion among financial services providers is less than perfect, and they can command greater profits than in an environment with perfect competition. Very large plans may exercise their own market power to negotiate lower prices, translating into savings for member employers and employee participants.

Sometimes, scale efficiencies would not translate into savings for small employer members and their employee participants because regulatory requirements applicable to large MEPs may be more stringent than those applicable to most separate small plans. For example, some small plans are exempt from annual reporting requirements, and many others are subject to more streamlined reporting requirements than larger plans. But in most cases, the savings from the scale efficiency of MEPs would be greater than the savings from scale efficiencies that other providers of bundled financial services may offer to small employers.

First, the legal status of MEPs as a single large plan may streamline certain regulatory burdens under the Code and title I of ERISA. For example, a MEP can file a single annual return/report and obtain a single bond in lieu of the multiple reports and bonds necessary when other providers of bundled financial services administer many separate plans.

Second, relative to separate small employer plans, a MEP operating as a large single plan would likely secure substantially lower prices from financial services companies. Asset managers commonly offer proportionately lower prices, relative to assets invested, to larger investors, under so-called tiered pricing practices. For example, investment companies often offer lower-priced mutual fund share classes to customers whose investments in a fund surpass specified break points. These lower prices may reflect scale economies in any or all aspects of administering larger accounts, such as marketing, distribution, asset management, recordkeeping, and transaction processing. MEPs that are larger would likely qualify for lower pricing compared with separate plans of small employers. MEP participants that benefit from lower asset-based fees would enjoy superior investment returns net of fees.

The availability and magnitude of scale efficiencies may be different with respect to different retirement plan services. For example, asset management generally enjoys very large-scale efficiencies. Investors of all kinds generally benefit by investing in large commingled pools. Even within large pools, however, small investors often pay higher fees than larger ones. Investors with more assets to invest may pay lower costs when using mutual funds as investment vehicles.

As with asset management, scale efficiencies often are available with respect to other plan services. For example, the marginal costs of services such as marketing and distribution, account administration, and transaction processing often decrease as customer size increases. Similarly, small pension plans sometimes incur high distribution costs, reflecting commissions paid to agents and brokers who sell investment products to plans. MEPs, as large customers, may enjoy scale efficiencies in the acquisition of such services. It is also possible, however, that the cost to MEPs of servicing many small employer-members may diminish or even offset such efficiencies. Stated differently, MEPs' scale efficiencies may not always exceed the scale efficiencies from other providers of bundled financial services used by small employers that sponsor separate plans. In addition, even if MEPs are able to enjoy scale efficiencies greater than the scale efficiencies available from other providers of bundled financial services, the scale efficiencies of MEPs catering to small businesses would still likely be smaller than the scale efficiencies enjoyed by very large single-employer plans.

By reducing the risk to employers of participating in a MEP, the proposed regulation would allow more MEPs to be established and to pursue scale advantages. It would also extend scale advantages to some existing MEPs that otherwise might have been too small to achieve them and to small employers that absent the proposed regulation would have offered separate plans (or no plans), but that under this proposed regulation may participate in a MEP.

While MEPs scale advantages may be smaller than the scale advantages enjoyed by very large single-employer plans, it nonetheless is illuminating to consider the savings historically enjoyed by the latter. For an illustration of how much investment fees vary based on the amount of assets in a 401(k) plan, see Table 3 in Section 7 of this Regulatory Impact Analysis, entitled *Tables*. The table focuses on mutual funds, which are the most common investment vehicle in 401(k) plans, and shows that the average expense ratio is inversely related to plan size. There are some important caveats to interpreting Table 3. The first is that it does not include data for most of the smallest plans since plans with fewer than 100 participants generally are not required to submit audited financial statements with their Form 5500. The second is that there is variation across plans in whether and to what degree the cost of recordkeeping is included in the expense ratios.

Another method for comparing plan size advantages is a broader measure called "total plan cost" calculated by BrightScope that includes fees reported on the audited Form 5500. As Table 4 shows, total plan cost yields generally similar results about the cost differences facing small and large plans. Deloitte Consulting LLP, for the Investment Company Institute, conducted a survey of 361 defined contributions plans.[16] The study calculates the "all-in" fee that is comparable across plans, and includes both administrative and investment fees paid by the plan and participants. Generally, small plans with 10 or fewer participants are paying approximately 50 basis points more than plans with more than 1,000 participants. Generally, small plans with 10 or fewer participants are paying about 90 basis points more than large plans with more than 50,000 participants.

The research studies described under this heading, *Reduced Fees and Administrative Costs,* show that small plans and their participants generally pay higher fees than large plans and their participants. Be-

[16] Deloitte Consulting and Investment Company Institute, "Inside the Structure of Defined Contribution/401(k) Plan Fees, 2013: A Study Assessing the Mechanics of the 'All-in' Fee" (Aug. 2014) (available at *https://www2.deloitte.com/content/dam/Deloitte/us/Documents/human-capital/us-cons-401k-fee-study-2013-082014.pdf*).

cause this rule would give many small employers the incentive to join a MEP, some of which may become very large plans, many of these employers would likely incur lower fees. Many employers that are not currently offering any retirement plan may join a MEP, leading their employees to save for retirement. Many employers already sponsoring a retirement plan might decide to join a MEP instead. If there are lower fees in the MEPs than in their previous plans, those lower fees would translate into higher savings.

c. *Reduced Reporting and Audit Costs*

The potential for MEPs to enjoy reporting cost savings merits separate attention because this potential is shaped not only by economic forces, but also the reporting requirements applicable to different plans. On the one hand, a MEP, as a single ERISA plan, can file a single report and conduct a single audit, while separate plans may be required to file separate reports and conduct separate audits. On the other hand, a MEP, as a large plan generally is subject to more stringent reporting and audit requirements than a small plan, which likely files no or streamlined reports and undergoes no audits. With respect to reporting and audits, MEPs may offer more savings to medium-sized employers (with 100 or more retirement plan participants) that are already subject to more stringent reporting and audit requirements than to small employers. Small employers that otherwise would have fallen outside of reporting and audit requirements sometimes would incur slightly higher costs by joining MEPs. This cost increase may still be offset by benefits described in other sections. From a broader point of view, if auditing becomes more prevalent because small employers join MEPs, that would lead to more and better quality data that would improve security for employers, participants and beneficiaries.

Sponsors of ERISA-covered retirement plans generally must file a Form 5500 annually, with all required schedules and attachments. The cost burden incurred to satisfy the Form 5500 related reporting requirements varies by plan type, size and complexity. Analyzing the 2016 Form 5500 filings, the Department of Labor estimates that the average cost to file the Form 5500 is as follows: $276 per filer for small (generally less than 100 plan participants) single-employer defined contribution plans eligible for Form 5500-SF; $437 per filer for small single-employer defined contribution plans not eligible to file Form 5500-SF; and $1,686 per filer for larger (generally 100 participants or more) single-employer defined contribution plans, plus the cost of an audit.

Additional schedules and reporting may be required for large and complex plans. For example, large retirement plans are required to attach auditors' reports to their Form 5500. Most small plans are not required to obtain or attach such reports. Hiring an auditor and obtaining an audit report can be costly for plans, and audit fees may increase as plans get larger or if plans are more complex. A recent report states that the fee to audit a 401(k) plan ranges between $6,500 and $13,000.[17]

If an employer joins a MEP, it may save some costs associated with filing Form 5500 and fulfilling audit requirements to the extent the MEP is considered a single plan under ERISA. Thus, one Form 5500 and audit report would satisfy the reporting requirements, and each participating employer would not need to file its own, separate Form 5500 and, for large plans or those few small plans that do not meet the small plan audit waiver, an audit report. Assuming reporting costs are shared by participating employers within a MEP, an employer joining a MEP can save virtually all the reporting costs discussed above. Large plans may enjoy even higher cost savings if audit costs are taken into account.

It is less clear whether the self-employed would experience similar reporting cost savings by joining a MEP. The Department of Labor estimated these potential cost savings by comparing the reporting costs of an employer that participates in a MEP rather than sponsoring its own plan. However, several retirement savings options are already available for self-employed persons, and most have minimal or no reporting requirements. For example, both SEP IRA and SIMPLE IRA plans are available for small employers and the self-employed and neither option requires Form 5500 filings. Solo 401(k) plans are also available for self-employed persons, and they may be exempt from the Form 5500-EZ reporting requirement if plan assets are less than $250,000. Thus, if self-employed individuals join a MEP, they would be unlikely to realize reporting cost savings. In fact, it is possible that their reporting costs may slightly increase, because the self-employed would share reporting costs with other MEP participating employers that they would otherwise not incur.[18]

d. *Reduced Bonding Costs*

The potential for bonding cost savings in MEPs merits separate attention. As noted above, ERISA section 412 and related regulations generally require every fiduciary of an employee benefit plan and every person who handles funds or other property of such a plan to be bonded. ERISA's bonding requirements are intended to protect employee benefit plans from risk of loss due to fraud or dishonesty on the part of persons who handle plan funds or other property, generally referred to as plan officials. A plan official must be bonded for at least 10 percent of the amount of funds he or she handles, subject to a minimum bond amount of $1,000 per plan with respect to which the plan official has handling functions. In most instances, the maximum bond amount that can be required under ERISA with respect to any one plan official is $500,000 per plan; however, the maximum required bond amount is $1,000,000 for plan officials of plans that hold employer securities.[19]

Under the proposed regulation, MEPs generally might enjoy lower bonding

[17] See *https://www.thayerpartnersllc.com/blog/the-hidden-costs-of-a-401k-audit*. However, in a comment letter received by the Department of Labor in response to its October 23, 2018 (83 FR 53534), proposed rule clarifying the circumstances under which an employer group or association or PEO may sponsor a MEP, an association reported that the cost of its MEP audit was $24,000. See comment letter #6 Employers Association of New Jersey, EANJ at *https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/public-comments/1210-AB88/00006.pdf*.

[18] However, self-employed participants, like all participants in small plans, would benefit from these enhanced audit and reporting requirements.

[19] See DOL Field Assistance Bulletin 2008-04, *https://www.dol.gov/agencies/ebsa/employers-and-advisers/guidance/field-assistance-bulletins/2008-04*.

costs than would an otherwise equivalent collection of small, separate plans, for two reasons. First, it might be less expensive to buy one bond covering a large number of individuals who handle plan funds than a large number of bonds covering the same individuals separately or in small, more numerous groups. Second, the number of people handling plan funds and therefore subject to ERISA's bonding requirement in the context of a MEP may be smaller than in the context of an otherwise equivalent collection of smaller, separate plans.

e. *Increased Retirement Savings*

The various effects of this rule, if finalized, may lead in aggregate to increased retirement savings. As discussed above, many employees would likely go from not having any access to a retirement plan to having access through a MEP. This has the potential to result in an increase in retirement savings, on average, for this group of employees. While some employees may choose not to participate, surveys indicate that a large number would participate. For a defined contribution pension plan, about 73 percent of all employees with access participate in the plan.[20] Among employees whose salary tends to be in the lowest 10 percent of the salary range, this figure is about 40 percent.[21] One reason that these take-up rates are relatively high is that many plans use automatic enrollment to enroll newly hired employees, as well as, sometimes existing employees. Automatic enrollment is particularly prevalent among large plans; in 2017 about 74 percent of plans with 1,000-4,999 participants used automatic enrollment, while only about 27 percent of plans with 1-49 participants did.[22]

Some workers may be saving in an IRA, either in an employer-sponsored IRA, payroll deduction IRA, or on their own. If they begin participating in a MEP 401(k), they would have the opportunity to take advantage of higher contribution limits, and some individuals may begin receiving employer contributions when participating in a MEP when they did not previously.

In general, MEPs may offer participants a way to save for retirement with lower overall costs. In particular, the fees are likely to be lower than in most small plans and in retail IRAs. The savings in fees would result in higher investment returns and thus higher retirement savings.

f. *Increased Labor Market Efficiency*

The increased prevalence of MEPs would allow small employers the opportunity to offer retirement benefits that are comparable to what large employers provide. Since employees value retirement benefits, this development would tend to shift talented employees toward small businesses. Moreover, certain groups such as secondary earners in high income families who have high marginal tax rates, and therefore larger benefits from tax-preferred savings, might now be more inclined to work for small businesses as those businesses might now offer a retirement plan. Such shifts would make small businesses more competitive. The ensuing reallocation of talent across different sectors of the economy would increase efficiency.

5. *Costs*

While the proposed regulation effectively lowers the cost of participation in a MEP among employers, the rule may also lead to increased levels of noncompliance. For example, the section 413(c) plan administrator may become less diligent about ensuring that participating employers within a MEP are responsible employers. By potentially increasing noncompliance, the proposed regulation would impose new costs on section 413(c) plan administrators who are ultimately responsible for managing unresponsive employers. In particular, for a plan to maintain its tax-favored status, the section 413(c) plan administrator is required to send notice to an unresponsive employer giving it 90 days to remedy the situation. If the unresponsive employer fails to comply, the plan administrator must send a second notice and then a final notice if the unresponsive employer still fails to comply after specified time periods. In the event of the initiation of the spinoff process, in which assets associated with an unresponsive employer are separated into a new plan that is then terminated, additional costs from the resulting compliance measures will be incurred by the section 413(c) plan administrator, who among other things is tasked with notifying all impacted participants and beneficiaries. These additional costs may be directly passed on to unresponsive employers. However, it's possible that section 413(c) plan administrators may spread these costs across all participating employers that would either absorb or pass those costs on to their employees.

The proposed regulation may also indirectly lead to an increase in investment fees by increasing uncertainty in the size of a MEP's asset pool. For example, a plan may shrink considerably when assets of an unresponsive participating employer are spun off depending on that employer's share of the total asset pool. Since the cost savings in investment fees is derived from economies of scale, introducing uncertainty in plan size might induce management companies to increase prices to account for that risk. This cost would likely be spread across all employers participating in the MEP that might then pass those costs on to their employees.

More general concerns pertaining to MEPs include their potential for abuse, such as fraud, mishandling of plan assets, or charging excessive fees.[23] Relative to single-employer plans, MEPs may be more susceptible to abuse since coordination across participating employers may lead to confusion regarding each individual firm's fiduciary responsibilities. On the other hand, the enhanced disclosure and audit requirements applicable to large plans, together with the increased number of employers participating in a plan, might call attention to abuses that would have otherwise gone unnoticed had a small employer established its own plan.

[20] U.S. Bureau of Labor Statistics, National Compensation Survey, Employee Benefits in the U.S. (March 2018).

[21] Id.

[22] Plan Sponsor Council of America, "61st Annual Survey of Profit Sharing and 401(k) Plans, Reflecting 2017 Plan Experience" (2018), Table 111.

[23] (83 FR 53534) (October 23, 2018).

6. *Regulatory Alternatives*

The Treasury Department and the IRS considered alternatives to the proposed regulation. One alternative would have been to extend the proposed regulations to include defined benefit MEPs. However, this alternative was rejected because defined benefit plans raise additional issues, including issues arising from the minimum funding requirements and spinoff rules, such as the treatment in such a spinoff of any plan underfunding or overfunding. Commenters are asked, in the Comments and Requests for Public Hearing section of the preamble, to address those issues, as well as the circumstances in which the exception to the unified plan rule should be available to defined benefit plans.

The Treasury Department and the IRS also considered whether the proposed regulation should include a more streamlined process for a section 413(c) plan administrator to satisfy the requirements for the exception to the unified plan rule. However, the notice requirements are intended to ensure that the affected participating employers and their employees are aware of the adverse consequences if the unresponsive participating employer neither takes appropriate remedial action nor initiates a spinoff, and the timing requirements are intended to give the unresponsive participating employer an adequate opportunity to take that remedial action or initiate a spinoff. These procedural requirements strike a balance between providing protection for unresponsive participating employers and their employees and not unduly burdening defined contribution MEPs. In the Comments and Requests for Public Hearing section of the preamble, commenters are asked to address whether the regulations should add mechanisms to avoid the potential for repetitive notices, as well as whether additional procedures should be added to facilitate the resolution of disputes between a section 413(c) plan administrator and an unresponsive participating employer.

7. *Tables*

TABLE 1—RETIREMENT PLAN COVERAGE BY EMPLOYER SIZE

Establishment size: Number of workers	Workers:		Establishments:
	Share with access to a retirement plan (%)	*Share participating in a retirement plan (%)*	*Share offering a retirement plan (%)*
1-49	49	34	45
50-99	65	46	75
100-499	79	58	88
500+	89	76	94
All	66	50	48

Source: These statistics apply to private industry. U.S. Bureau of Labor Statistics, National Compensation Survey, Employee Benefits in the U.S. (March 2018).

TABLE 2—CURRENT STATISTICS ON MEPS

	Number of MEPs	Total Participants	Active Participants	Total Assets
MEP Defined Contribution Plans	4,630	4.4 million	3.7 million	$181 billion
As a share of all ERISA Defined Contribution Plans	0.7%	4.4%	4.6%	3.2%
MEP Defined Contribution Plans	4,630	4.4 million	3.7 million	$181 billion
401(k) Plans	4,391	4.1 million	3.4 million	$166 billion
Other Defined Contribution Plans	239	0.4 million	0.3 million	$15 billion

Source: The Department of Labor performed these calculations using the 2016 Research File of Form 5500 filings. The estimates are weighted and rounded, which means they may not sum precisely. These estimates were derived by classifying a plan as a MEP if it indicated ‘‘multiple employer plan’’ status on the Form 5500 Part 1 Line A and if it did not report collective bargaining.

TABLE 3—AVERAGE EXPENSE RATIOS OF MUTUAL FUNDS IN 401(K) PLANS IN BASIS POINTS, 2015

Plan Assets	Domestic equity mutual funds	International equity mutual funds	Domestic bond mutual funds	International bond mutual funds	Target date mutual funds	Balanced mutual funds (non-target date)
$1M-$10M	81	101	72	85	79	80
$10M-$50M	68	85	59	77	68	64
$50M-$100M	55	72	44	66	54	50
$100M-$250M	52	68	40	64	55	45
$250M-$500M	49	63	36	67	50	42
$500M-$1B	45	60	33	65	50	39
More than $1B	36	52	26	65	48	32

Source: Average expense ratios are expressed in basis points and asset-weighted. The sample includes plans with audited 401(k) filings in the BrightScope database for 2015 and comprises 15,110 plans with $1.4 trillion in mutual fund assets. Plans were included if they had at least $1million in assets and between 4 and 100 investment options. BrightScope/ICI, "The BrightScope/ICI Defined Contribution Plan Profile: A Close Look at 401(k) Plans, 2015" (March 2018).

TABLE 4—LARGER PLANS TEND TO HAVE LOWER FEES OVERALL

Plan Assets	Total Plan Cost (in basis points)		
	10th Percentile	*Median*	*90th Percentile*
$1M-$10M	75	111	162
$10M-$50M	61	91	129
$50M-$100M	37	65	93
$100M-$250M	22	54	74
$250M-$500M	21	48	66
$500M-$1B	21	43	59
More than $1B	14	27	51

Source: Data is plan-weighted. The sample is plans with audited 401(k) filings in the BrightScope database for 2015, which comprises 18,853 plans with $3.2 trillion in assets. Plans were included if they had at least $1 million in assets and between 4 and 100 investment options. BrightScope/ICI, "The BrightScope/ICI Defined Contribution Plan Profile: A Close Look at 401(k) Plans, 2015" (March 2018).

II. Paperwork Reduction Act

The collection of information in these proposed regulations is in: §1.413-2(g)(3)(i)(B) (requirement to adopt plan language); §1.413-2(g)(4) (requirement to provide notice with respect to a participating employer failure); §1.413-2(g)(7)(i)(C) (requirement that spun-off plan have the same substantive terms as MEP); and §1.413-2(g)(7)(i)(A) (requirement to provide notice of a spinoff-termination). The collection of information contained in proposed §1.413-2(g) will be carried out by plan administrators of defined contribution MEPs seeking to satisfy the conditions for the exception to the unified plan rule. The collection of information in this notice of proposed rulemaking has been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)).

1. *Plan Amendment Adoption Requirement, §1.413-2(g)(3)(i)(B)*

Section 1.413-2(g)(3)(i)(B) states that as a condition of the exception to the unified plan rule, a defined contribution MEP must be amended to include plan language that describes the procedures that would be followed to address participating employer failures, including the applicable procedures that apply if an unresponsive participating employer does not respond to the section 413(c) plan administrator's requests to remedy the failures.

A defined contribution MEP will not be eligible for the exception to the unified plan rule if it does not satisfy this plan-language requirement. Without it, the defined contribution MEP will not be able to avail itself of the exception to the unified plan rule, and will continue to be at risk of disqualification due to the actions or inaction of a single unresponsive participating employer. Since only one amendment is required, this is a one-time paperwork burden for each defined contribution MEP. In addition, after final regulations are issued, the IRS intends to publish a model plan amendment, which will help to minimize the burden.

We estimate that the burden for this requirement under the Paperwork Reduction Act of 1995 will be three hours per defined contribution MEP. Given the size of the burden and the potential benefits of satisfying the exception to the unified plan rule, we estimate that approximately 80 percent of defined contribution MEPs (3,704 MEPs)[24] will amend their plans to satisfy this condition. Therefore, the total burden of this requirement is estimated to be 11,112 hours (3,704 defined contribution MEPs times three hours). However, because each defined contribution MEP that adopts an amendment will do so on a one-time basis, to determine an annual estimate, the total time is divided by three, or 3,704 hours annually (3,704 defined contribution MEPs times one hour).

2. *Notice Requirements, §1.413-2(g)(4)*

Notice is another condition of the exception to the unified plan rule. The proposed regulations would require a section 413(c) plan administrator to send up to three notices informing the unresponsive participating employer of the participating employer failure and the consequences if the employer fails to take remedial action or initiate a spinoff from the defined contribution MEP. After each notice is provided, the employer has 90 days to take appropriate remedial action or initiate a spinoff from the defined contribution MEP. If the employer takes those actions after the first or second notice is provided, subsequent notices are not required. Thus, it is possible that a section 413(c) plan administrator will send fewer than three notices to an employer. However, because the notice requirements only apply if an employer has already been unresponsive to the section 413(c) plan administrator's requests, we have estimated that in most cases, all three notices will be provided.

We estimate that the burden of preparing the three notices will be three hours. Most of this burden relates to the first notice, which must describe the qualification failure and the potential consequences if the employer fails to take action to address it. The burdens of preparing the second and third notices are expected to be relatively insignificant, given that these notices must generally repeat the information that was included in the first notice. We estimate that approximately 33.3 percent of all defined contribution MEPs (1,542 defined contribution MEPs) have or will have an unresponsive participating employer, necessitating the sending of these notices on an annual basis. Therefore, we estimate a burden of 4,626 hours (1,542 defined contribution MEPs times three hours). We expect to be able to adjust these estimates based on experience after the regulations are finalized.

Section 1.413-2(g)(4) also includes the burden of notice distribution. All three notices must be sent to the unresponsive participating employer. The third notice will also be provided to plan participants who are employees of the unresponsive participating employer (and their beneficiaries) and to the Department of Labor. We estimate that, on average, a section 413(c) plan administrator will send the third notice to approximately 50 recipients (employees of the unresponsive participating employer, the employer, and the Department of Labor). We expect that the burden of distributing these notices will be two hours per defined contribution MEP, for a total burden of 3,084 hours (1,542 defined contribution MEPs times two hours).

3. *Terms of Spun-off Plan, §1.413-2(g)(7)(i)(C)*

After the third notice is provided, §1.413-2(g)(7)(i)(C) requires a section 413(c) plan administrator to implement a spinoff of the plan assets attributable to employees of an unresponsive participating employer. The assets must be spun-off into a separate plan that has the same substantive plan terms as the defined contribution MEP. We estimate that in a given year, a spinoff-termination for an unresponsive participating employer will be made with respect to 20 percent of all defined contribution MEPs (926 defined contribution MEPs therefore will be subject to this requirement). We also estimate that the burden associated with the requirement to create a spinoff plan will be 10 hours. Therefore, the total burden is estimated to be 9,260 hours (926 defined contribution MEPs times 10).

4. *Notice of Spinoff-Termination, §1.413-2(g)(7)(i)(A)*

A section 413(c) plan administrator implementing a spinoff-termination pursuant to §1.413-2(g)(7) must provide notification of the spinoff-termination to participants who are employees of the unresponsive employer. This notice requirement is in §1.413-2(g)(7)(i)(A). We estimate that in a given year, 20 percent of all defined contribution MEPs (926 defined contribution MEPs) will implement a spinoff-termination of an unresponsive participating employer, and notice to participants will need to be provided with respect to those spinoff-terminations.

Using the same numbers as the estimates for notice requirements under §1.413-2(g)(4), we estimate that for a defined contribution MEP that uses the exception to the unified plan rule, approximately 50 notices of a spinoff-termination will need to be sent to participants who are employees of the unresponsive participating employer (and their beneficiaries). We also estimate that the total burden for this requirement is five hours. Based on this number, we estimate that the burden of preparing and distributing the notices will be 4,630 hours (926 defined contribution MEPs times five hours).

5. *Reporting Spinoff or Spinoff-Termination to IRS, §§1.413-2(g)(6)(ii) and (g)(7)(iv)*

Any spinoff or spinoff-termination from a defined contribution MEP under the proposed regulations must be reported to the IRS (in accordance with forms, instructions, and other guidance). Because the IRS anticipates issuing a new form or revising an existing form for this purpose, the estimated reporting burden associated with proposed §§1.413-2(g)(6)(ii) and (g)(7)(iv) will be reflected in the reporting burden associated with those forms, and therefore is not included here.

Comments on the collection of information should be sent to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regula-

[24] This calculation uses data from the 2016 Form 5500, "Annual Return/Report of Employee Benefit Plan." As noted earlier, these filings indicate that there are approximately 4,630 defined contribution MEPs.

tory Affairs, Washington, DC 20503, with copies to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP; Washington, DC 20224. Comments on the collection of information should be received by September 3, 2019. Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper performance of the functions of the IRS, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information;

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collections of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of service to provide information.

Estimated total average annual recordkeeping burden: 25,304 hours.

Estimated average annual burden per response: Between 7 and 27 hours.

Estimated number of recordkeepers: 926 to 3,704.

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

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

III. *Regulatory Flexibility Act*

The Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*) (RFA) imposes certain requirements with respect to 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.*) and that are likely to have a significant economic impact on a substantial number of small entities. Unless an agency determines that a proposal is not likely to 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 (IRFA) of the proposed rule. The Treasury Department and the IRS have not determined whether the proposed rule, when finalized, will likely have a significant economic impact on a substantial number of small entities. The determination of whether creating an exception to the unified plan rule for defined contribution MEPs will have a significant economic impact requires further study. However, because there is a possibility of significant economic impact on a substantial number of small entities, an IRFA is provided in these proposed regulations. The Treasury Department and the IRS invite comments on both the number of entities affected and the economic impact on small entities.

Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking has been submitted to the Chief Counsel of Advocacy of the Small Business Administration for comment on its impact on small business.

1. *Need for and Objectives of the Rule*

As discussed earlier in this preamble, under the unified plan rule, the failure of one employer participating in a MEP to satisfy a qualification requirement or to provide information needed to determine compliance with a qualification requirement puts the tax-favored status of the entire MEP at risk. By creating an exception to the unified plan rule, the proposed rule would ensure that, in certain circumstances, compliant participating employers will continue to maintain a qualified plan. Offering a workplace retirement plan is a valuable tool for small businesses in recruiting and retaining employees. By retaining tax-favored status in a defined contribution MEP, participating employers will continue to be able to offer a workplace retirement plan for their employees.

The proposed rule is expected to encourage the establishment of new defined contribution MEPs, as well as increase the participation of employers in existing defined contribution MEPs, in accordance with Executive Order 13847 and the policy of expanding workplace retirement plan coverage. MEPs are an efficient way to reduce costs and complexity associated with establishing and maintaining defined contribution plans, which could encourage more plan formation and broader availability of more affordable workplace retirement savings plans, especially among small employers and certain working owners. Thus, the Treasury Department and the IRS intend and expect that the proposed rule would deliver benefits primarily to the employees of many small businesses and their families, as well as many small businesses themselves.

2. *Affected Small Entities*

The Small Business Administration estimates in its 2018 Small Business Profile that 99.9 percent of United States businesses meet its definition of a small business.[25] The applicability of these proposed regulations does not depend on the size of the business, as defined by the Small Business Administration. The Treasury Department and the IRS expect that the smallest businesses, those with less than 50 employees, are most likely to benefit from the savings derived from retaining tax-favored status in a defined contribution MEP, as well as increasing participation in defined contribution MEPs, which are expected to occur as a result of the proposed rule. In Section 7 of the Regulatory Impact Analysis, see Table 1, which provides statistics on retirement plan coverage by the size of the employer. These same types of employers, which are disproportionately small businesses, are more likely to participate in a workplace retirement plan after the proposed rule is

[25] The Small Business Administration, Office of Advocacy, 2018 Small Business Profile. *https://www.sba.gov/sites/default/files/advocacy/2018-Small-Business-Profiles-US.pdf*. Last accessed 03/28/2019. For purposes of the 2018 Small Business Profile, small businesses are defined as firms employing fewer than 500 employees.

finalized. The proposed rule will also affect small entities that participate in MEPs at the time the rule is finalized.

3. *Impact of the Rule*

Under the existing unified plan rule, a MEP may be disqualified due to the actions of one unresponsive participating employer. Upon disqualification, employers participating in a MEP and their employees would lose the tax benefits of participating in a qualified retirement plan (deduction for contributions, exclusion of investment returns, and deferred income recognition for employees). By creating an exception to the unified plan rule, the proposed regulation would allow a defined contribution MEP to remain qualified and thereby retain tax-favored benefits for participating employers and their employees. For example, if a defined contribution MEP that would have otherwise been disqualified satisfies the conditions for the exception to the unified plan rule, small entities that participate in the MEP will be able to continue to make contributions to the defined contribution MEP that are deductible under section 404(a)(3).

In addition, as previously stated in the Special Analysis section of this preamble, this proposed rule could potentially result in an expansion of defined contribution MEPs, which could create a more affordable option for retirement savings coverage for many small businesses, thereby potentially yielding economic benefits for participating employers and their employees. Some advantages of a workplace retirement plan (including 401(k) plans, SEP-IRAs, and SIMPLE IRAs) over IRA-based savings options outside the workplace include: (1) higher contribution limits; (2) potentially lower investment management fees, especially in larger plans; (3) a well-established uniform regulatory structure with important consumer protections, including qualification requirements relating to protected benefits, vesting, disclosures, and spousal protections; (4) automatic enrollment; and (5) stronger protections from creditors. At the same time, workplace retirement plans provide employers with choice among plan features and the flexibility to tailor retirement plans that meet their business and employment needs.

The ERISA recordkeeping and reporting requirements could decrease for some small employers that would have maintained a single-employer defined contribution plan but instead join a defined contribution MEP. This includes costs associated with filing Form 5500 and fulfilling audit requirements to the extent a MEP is considered a single plan under ERISA. Thus, one Form 5500 and audit report would satisfy the reporting requirements, and each participating employer would not need to file its own, separate Form 5500 and, for large plans or those few small plans that do not meet the small plan audit waiver, an audit report.

The cost savings of an employer participating in a defined contribution MEP may be partially offset by the costs of complying with the conditions for the exception to the unified plan rule, including new recordkeeping and reporting requirements. Additional costs from these actions will be incurred by the section 413(c) plan administrator, who among other things is tasked with adopting plan language (§1.413-2(g)(3)(i)(B)), providing notice concerning a participating employer failure to unresponsive participating employers, participants, beneficiaries, and the Department of Labor (§1.413-2(g)(4)), notifying participants and beneficiaries of a spinoff-termination (§1.413-2(g)(7)(ii)), and implementing a spinoff of the MEP assets related to an unresponsive participating employer and creating a spun-off plan document (§1.413-2(g)(7)(i)). Although the Treasury Department and the IRS do not have sufficient data to determine precisely the likely extent of the increased costs of compliance, the estimated burden of complying with the recordkeeping and reporting requirements are described in the *Paperwork Reduction Act* section of the preamble. While the burdens associated with the recordkeeping and reporting requirements are imposed on the defined contribution MEP and not the participating employers, those additional costs may be directly passed on to participating employers.

Another partial offset to the cost savings is the potential for an unresponsive participating employer to have its participation in a MEP terminated as a result of the MEP's compliance with these proposed regulations. The proposed regulations state that if an unresponsive participating employer fails to take appropriate remedial action to correct a qualification failure, one of the following actions must occur in order for the MEP to meet the conditions for the exception to the unified plan rule: (a) a spinoff initiated by the unresponsive participating employer and implemented by the section 413(c) plan administrator or (b) a spinoff-termination pursuant to plan terms. The Treasury Department and the IRS anticipate that compared to the number of small entities that will benefit from these proposed rules, relatively few employers will have their plans spun-off or spun-off and terminated.

As previously stated in the Regulatory Impact Analysis of this preamble, the Treasury Department and the IRS considered alternatives to the proposed regulations. One of the conditions that a defined contribution MEP must satisfy in order to be eligible for the exception to the unified plan rule is that the section 413(c) plan administrator provides notice and an opportunity for the unresponsive participating employer to take action with respect to the participating employer failure. The proposed regulations would require that the section 413(c) plan administrator provide up to three notices to the unresponsive participating employer, informing the employer (and in some cases, participants and the Department of Labor) of the participating employer failure and the consequences for failing to take remedial action or initiate a spinoff from the defined contribution MEP. After each notice is provided, the unresponsive participating employer has 90 days to take appropriate remedial action or initiate a spinoff from the defined contribution MEP. For more information about the notice requirements, see Section II.B of the Explanation of Provisions in this preamble.

In addition to the alternatives discussed in the Regulatory Impact Analysis of this preamble, the Treasury Department and the IRS considered whether the proposed regulations should reduce the number of notices or the timing between providing notices in order for a section 413(c) plan administrator to satisfy this condition for the exception to the unified plan rule. The notice and accompanying timing requirements were provided for because the notice procedures are intended to ensure that an unresponsive participating employer and its employees are aware of the adverse consequences if the employer neither takes appropriate remedial action nor initiates a spinoff, and the timing requirements are intended to give the unresponsive participating employer sufficient time to take that remedial action or initiate a spinoff. The Treasury Department and the IRS believe that, given the adverse consequences of a spinoff-termination to plan participants, the notice and accompanying timing requirements strike a balance between providing protection for unresponsive participating employers and their employees and not unduly burdening the section 413(c) plan administrators in defined contribution MEPs. In the Comments and Requests for Public Hearing section of the preamble, commenters are asked to address whether the regulations should add mechanisms to avoid the potential for repetitive notices, as well as whether additional procedures should be added to facilitate the resolution of disputes between a section 413(c) plan administrator and an unresponsive participating employer.

4. *Duplicate, Overlapping, or Relevant Federal Rules*

The proposed rule would not conflict with any relevant federal rules. As discussed above, the proposed rule would merely create an exception to the unified plan rule for defined contribution MEPs.

Comments and Requests for Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any comments that are submitted timely to the Treasury Department and the IRS as prescribed in this preamble under the **"ADDRESSES"** heading. The Treasury Department and the IRS request comments on all aspects of the proposed rules. Comments specifically are requested on the following topics:

- The circumstances, if any, in which the exception to the unified plan rule should be available to defined benefit plans (taking into account issues arising from the minimum funding requirements and spinoff rules for defined benefit plans, including the treatment in such a spinoff of any plan underfunding or overfunding).
- Whether the regulations should include additional requirements for MEPs to be eligible for the exception to the unified plan rule, including additional procedures to facilitate the resolution of disputes between a section 413(c) plan administrator and an unresponsive participating employer.
- Whether the regulations should add appropriate mechanisms to avoid the potential for repetitive notices or to shorten the notice period for a potential qualification failure that becomes a known qualification failure. Those mechanisms might include, for example, treating the first notice that the section 413(c) plan administrator provided in connection with the potential qualification failure as satisfying the requirement to provide the first notice in connection with the known qualification failure, with appropriate modification of the second and third notices.
- For purposes of a spinoff, how to treat participants who have a single account with assets attributable to service with the unresponsive participating employer and one or more other participating employers, or who have a separate rollover account that is not attributable to service with the unresponsive participating employer.
- What additional guidance should be provided on terminating a plan in the case of a spinoff-termination. This might include, for example, rules that are similar to the relief provided in section 4, Q&A-1, of Rev. Proc. 2003-86, 2003-2 C.B. 1211, that any other plan maintained by an unresponsive participating employer will not be treated as an alternative plan under §1.401(k)-1(d)(4)(i) for purposes of the ability to make distributions upon termination of the spun-off plan. It might also address the §1.411(a)-11(e)(1) rules for distributions upon plan termination
- Whether there are any studies that would help to quantify the impact of the proposed regulations.

Also, consistent with the Executive Order, comments are specifically requested on any steps that the Secretary of Labor should take to facilitate the implementation of these proposed regulations. The Department of Labor has informed the Treasury Department and the IRS that a section 413(c) plan administrator implementing a spinoff-termination may have concerns about its fiduciary responsibility both to the MEP and to the spun-off plan, as well as potential prohibited transaction issues. Commenters are encouraged to provide feedback on these issues and address the need for additional interpretive guidance or prohibited transaction exemptions from the Department of Labor to facilitate the implementation of these regulations.[26] Copies of comments on these topics will be forwarded to the Department of Labor.

All comments will be available for public inspection and copying at *www.regulations.gov* or upon request. A public hearing will be scheduled if requested in writing by any person who timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place of the public hearing will be published in the **Federal Register**.

Drafting Information

The principal authors of these regulations are Jamie Dvoretzky and Pamela Kinard, Office of Associate Chief Counsel (Employee Benefits, Exempt Organizations, and Employment Taxes (EEE)). However, other personnel from the IRS and the Treasury Department participated in the development of these regulations.

* * * * *

Proposed Amendments to the Regulations

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

[26] For an example of this type of interpretative guidance and a related prohibited transaction exemption in the context of a terminating abandoned plan, *see* 29 CFR 2578.1 (establishing procedures for qualified termination administrators to terminate abandoned plans and distribute benefits with limited liability under title I of ERISA) and Prohibited Transaction Exemption 2006-06 (71 FR 20856, Apr. 21, 2006).

PART 1—INCOME TAXES

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

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

Par. 2. Section 1.413-2 is amended by:

1. Removing paragraph (a)(3)(iv).
2. Adding and reserving paragraphs (e) and (f).
3. Adding paragraph (g).

The additions read as follows:

§1.413-2 Special rules for plans maintained by more than one employer.

* * * * *

(e) [Reserved]

(f) [Reserved]

(g) *Qualification of a section 413(c) plan*—(1) *General rule*. Except as provided in paragraph (g)(2) of this section, the qualification of a section 413(c) plan under section 401(a) or 403(a), taking into account the rules of section 413(c) and this section, is determined with respect to all participating employers. Consequently, the failure by one participating employer (or by the plan itself) to satisfy an applicable qualification requirement will result in the disqualification of the section 413(c) plan for all participating employers.

(2) *Exception to general rule for participating employer failures*—(i) *In general*. A section 413(c) plan that is a defined contribution plan will not be disqualified on account of a participating employer failure, provided that the following conditions are satisfied—

(A) The section 413(c) plan satisfies the eligibility requirements of paragraph (g)(3) of this section;

(B) The section 413(c) plan administrator satisfies the notice requirements described in paragraph (g)(4) of this section;

(C) If the unresponsive participating employer fails to take appropriate remedial action with respect to the participating employer failure, as described in paragraph (g)(5)(ii) of this section, the section 413(c) plan administrator implements a spinoff described in paragraph (g)(2)(ii) of this section; and

(D) The section 413(c) plan administrator complies with any information request that the IRS or a representative of the spun-off plan makes in connection with an IRS examination of the spun-off plan, including any information request related to the participation of the unresponsive participating employer in the section 413(c) plan for years prior to the spinoff.

(ii) *Spinoff*. A spinoff is described in this paragraph (g)(2)(ii) if it satisfies either of the following requirements—

(A) The spinoff is initiated by the unresponsive participating employer, as described in paragraph (g)(5)(iii) of this section, and implemented by the section 413(c) plan administrator, as described in paragraph (g)(6)(ii) of this section; or

(B) The spinoff is a spinoff-termination pursuant to plan terms, as described in paragraph (g)(7) of this section.

(iii) *Definitions*. The following definitions apply for purposes of this paragraph (g):

(A) *Employee*. An employee is a current or former employee of a participating employer.

(B) *Known qualification failure*. A known qualification failure is a failure to satisfy a qualification requirement with respect to a section 413(c) plan that is identified by the section 413(c) plan administrator and is attributable solely to an unresponsive participating employer. For purposes of this paragraph (g)(2)(iii)(B), an unresponsive participating employer includes any employer that is treated as a single employer with that unresponsive participating employer under section 414(b), (c), (m), or (o).

(C) *Participating employer*. A participating employer is one of the employers maintaining a section 413(c) plan.

(D) *Participating employer failure*. A participating employer failure is a known qualification failure or a potential qualification failure.

(E) *Potential qualification failure*. A potential qualification failure is a failure to satisfy a qualification requirement with respect to a section 413(c) plan that the section 413(c) plan administrator reasonably believes might exist, but the section 413(c) plan administrator is unable to determine whether the qualification requirement is satisfied solely due to an unresponsive participating employer's failure to provide data, documents, or any other information necessary to determine whether the section 413(c) plan is in compliance with the qualification requirement as it relates to the participating employer. For purposes of this paragraph (g)(2)(iii)(E), an unresponsive participating employer includes any employer that is treated as a single employer with that unresponsive participating employer under section 414(b), (c), (m), or (o).

(F) *Section 413(c) plan administrator*. A section 413(c) plan administrator is the plan administrator of a section 413(c) plan, determined under the rules of section 414(g).

(G) *Unresponsive participating employer*. An unresponsive participating employer is a participating employer in a section 413(c) plan that fails to comply with reasonable and timely requests from the section 413(c) plan administrator for information needed to determine compliance with a qualification requirement or fails to comply with reasonable and timely requests from the section 413(c) plan administrator to take actions that are needed to correct a failure to satisfy a qualification requirement as it relates to the participating employer.

(3) *Eligibility for exception to general rule*—(i) *In general*. To be eligible for the exception described in paragraph (g)(2) of this section, a section 413(c) plan must satisfy the following requirements—

(A) *Practices and procedures*. The section 413(c) plan administrator has established practices and procedures (formal or informal) that are reasonably designed to promote and facilitate overall compliance with applicable Code requirements, including procedures for obtaining information from participating employers.

(B) *Plan language*. The section 413(c) plan document describes the procedures that would be followed to address participating employer failures, including the procedures that the section 413(c) plan administrator would follow if the unresponsive participating employer does not take appropriate remedial action or initiate a spinoff pursuant to paragraph (g)(5) of this section.

(C) *Not under examination*. At the time the first notice described in paragraph (g)(4)(i) of this section is provided to the unresponsive participating employer, the section 413(c) plan is not under examination under the rules of paragraph (g)(3)(ii) of this section.

(ii) *Under examination*. For purposes of this section, a plan is under examination if—

(A) The plan is under an Employee Plans examination (that is, an examination of a Form 5500 series or other examination by the Employee Plans Office of the Tax Exempt and Government Entities Division of the IRS (Employee Plans) (or any successor IRS office that has jurisdiction over qualified retirement plans));

(B) The plan is under investigation by the Criminal Investigation Division of the IRS (or its successor); or

(C) The plan is treated as under an Employee Plans examination under the rules of paragraph (g)(3)(iii) of this section.

(iii) *Certain plans treated as under an Employee Plans examination*—(A) *Notification of pending examination*. For purposes of this section, a plan is treated as under an Employee Plans examination if the section 413(c) plan administrator, or an authorized representative, has received verbal or written notification from Employee Plans of an impending Employee Plans examination, or of an impending referral for an Employee Plans examination. A plan is also treated as under an Employee Plans examination if it has been under an Employee Plans examination and the plan has an appeal pending with the IRS Office of Appeals (or its successor), or is in litigation with the IRS, regarding issues raised in an Employee Plans examination.

(B) *Pending determination letter application*—(*1*) *Possible failures identified by IRS*. For purposes of this section, a section 413(c) plan is treated as under an Employee Plans examination if a Form 5300, "Application for Determination for Employee Benefit Plan," Form 5307, "Application for Determination for Adopters of Modified Volume Submitter Plans," or Form 5310, "Application for Determination for Terminating Plan" (or any successor form for one or more of these forms) has been submitted with respect to the plan and the IRS agent notifies the applicant of possible qualification failures, whether or not the applicant is officially notified of an examination. This includes a case in which, for example, a determination letter on plan termination had been submitted with respect to the plan, and an IRS agent notifies the applicant that there are partial termination concerns. In addition, if, during the review process, the IRS agent requests additional information that indicates the existence of a failure not previously identified by the applicant, then the plan is treated as under an Employee Plans examination (even if the determination letter application is subsequently withdrawn).

(*2*) *Failures identified by determination letter applicant*. For purposes of paragraph (g)(3)(iii)(B)(*1*) of this section, an IRS agent is not treated as notifying a determination letter applicant of a possible qualification failure if the applicant (or the authorized representative) has identified the failure, in writing, to the reviewing IRS agent before the agent recognizes the existence of the failure or addresses the failure in communications with the applicant. For purposes of this paragraph (g)(3)(iii)(B)(*2*), submission of a determination letter application does not constitute an identification of a failure to the IRS.

(C) *Aggregated plans*. For purposes of this section, a plan is treated as under an Employee Plans examination if it is aggregated for purposes of satisfying the nondiscrimination requirements of section 401(a)(4), the minimum participation requirements of section 401(a)(26), the minimum coverage requirements of section 410(b), or the requirements of section 403(b)(12)(A)(i), with any plan that is under an Employee Plans examination. In addition, a plan is treated as under an Employee Plans examination with respect to a failure of a qualification requirement (other than those described in the preceding sentence) if the plan is aggregated with another plan for purposes of satisfying that qualification requirement (for example, section 401(a)(30), 415, or 416) and that other plan is under an Employee Plans examination. For purposes of this paragraph (g)(3)(iii)(C), the term aggregation does not include consideration of benefits provided by various plans for purposes of the average benefits test set forth in section 410(b)(2).

(4) *Notice requirements*. The section 413(c) plan administrator satisfies the notice requirements with respect to a participating employer failure if it satisfies the requirements of this paragraph (g)(4).

(i) *First notice*. The section 413(c) plan administrator must provide notice to the unresponsive participating employer describing the participating employer failure, the remedial actions the employer would need to take to remedy the failure, and the employer's option to initiate a spinoff of plan assets and account balances attributable to participants who are employees of that employer. In addition, the notice must explain the consequences under plan terms if the unresponsive participating employer neither takes appropriate remedial action with respect to the participating employer failure nor initiates a spinoff, including the possibility that a spinoff of assets and account balances attributable to participants who are employees of that employer would occur, followed by a termination of that plan.

(ii) *Second notice*. If, by the end of the 90-day period following the date the first notice described in paragraph (g)(4)(i) of this section is provided, the unresponsive participating employer neither takes appropriate remedial action with respect to the participating employer failure nor initiates a spinoff, then the section 413(c) plan administrator must provide a second notice to the employer. The second notice must be provided no later than 30 days after the expiration of the 90-day period described in the preceding sentence. The second notice must include the information required to be included in the first notice and must also specify that if, within 90 days following the date the second notice is provided, the employer neither takes appropriate remedial action with respect to the participating employer failure nor initiates a spinoff, a notice describing the participating employer failure and the consequences of not correcting that failure will be provided to participants who are employees of the unresponsive participating employer (and their beneficiaries) and to the Department of Labor.

(iii) *Third notice*. If, by the end of the 90-day period following the date the second notice described in paragraph (g)(4)(ii) of this section is provided, the unresponsive participating employer neither takes appropriate remedial action with respect to the participating employer failure nor initiates a spinoff, then the section 413(c) plan administrator must provide a third notice to that employer. The third notice must be provided no later than 30 days after the expiration of the 90-day period described in the preceding sentence. Within this time period, the third notice must also be provided to participants who are employees of that employer (and their beneficiaries) and to the Office of Enforcement of the Employee Benefits Security Administration in the Department of Labor (or its successor office). The third notice must include the information required to be included in the first notice, the deadline for employer action, and an explanation of any adverse consequences to participants in the event that a spinoff-termination occurs, and state that the notice is being provided to participants who are employees of the unresponsive participating employer (and their beneficiaries) and to the Department of Labor.

(5) *Actions by unresponsive participating employer*—(i) *In general*. An unresponsive participating employer takes appropriate remedial action with respect to a participating employer failure for purposes of paragraph (g)(2)(i)(C) of this section if it satisfies the requirements of paragraph (g)(5)(ii) of this section. Alternatively, an unresponsive participating employer initiates a spinoff with respect to a participating employer failure for purposes of paragraph (g)(2)(ii)(A) of this section if the employer satisfies the requirements of paragraph (g)(5)(iii) of this section. The final deadline for an unresponsive participating employer to take one of these actions is 90 days after the third notice is provided. See paragraph (g)(7) of this section for the consequences of the employer's failure to meet this deadline.

(ii) *Appropriate remedial action*—(A) *Appropriate remedial action with respect to potential qualification failure*. An unresponsive participating employer takes appropriate remedial action with respect to a potential qualification failure if the employer provides data, documents, or any other information necessary for the section 413(c) plan administrator to determine whether a qualification failure exists. If the unresponsive participating employer provides this information, the section 413(c) plan administrator determines that, based on this information, a qualification failure exists that is attributable solely to that employer, and the participating employer fails to comply with reasonable and timely requests from the section 413(c) plan administrator to take actions that are needed to correct that qualification failure, then the qualification failure becomes a known qualification failure. In that case, the section 413(c) plan will be eligible for the exception in paragraph (g)(2) of this section with respect to the known qualification failure by satisfying the conditions set forth in paragraph (g)(2) of this section with respect to that known qualification failure, taking into account the rules of paragraph (g)(6)(i) of this section.

(B) *Appropriate remedial action with respect to known qualification failure*. An unresponsive participating employer takes appropriate remedial action with respect to a known qualification failure if the employer takes action, such as making corrective contributions, that corrects, or enables the section 413(c) plan administrator to correct, the known qualification failure.

(iii) *Employer-initiated spinoff*. An unresponsive participating employer initiates a spinoff pursuant to this paragraph (g)(5)(iii) if, after receiving a notice described in paragraph (g)(4) of this section, the employer directs the section 413(c) plan administrator to spin off plan assets and account balances held on behalf of its employees to a separate single-employer plan established and maintained by that employer in a manner consistent with plan terms.

(6) *Actions by section 413(c) plan administrator*—(i) *Rules for a potential qualification failure that becomes a known qualification failure*. For purposes of applying paragraph (g)(2) of this section to a potential qualification failure that becomes a known qualification failure, actions taken (including notices provided) when the failure was a potential qualification failure are not taken into account. For example, a notice that the section 413(c) plan administrator provided in connection with the potential qualification failure would not satisfy the notice requirements for the known qualification failure. However, in determining whether the section 413(c) plan is under examination, as described in paragraph (g)(3)(iii) of this section, as of the date of the first notice describing the known qualification failure, the section 413(c) plan administrator will be treated as providing that notice on the date the first notice was provided with respect to the related potential qualification failure, but only if the following conditions are satisfied—

(A) After determining that a qualification failure exists, the section 413(c) plan administrator makes a reasonable and timely request to the participating employer to take actions that are needed to correct the failure, and

(B) As soon as reasonably practicable after the participating employer fails to respond to that request, the section 413(c) plan administrator provides the first notice described in paragraph (g)(4)(i) of this section with respect to the known qualification failure.

(ii) *Implementing employer-initiated spinoff*. If an unresponsive participating employer initiates a spinoff pursuant to paragraph (g)(5)(iii) of this section by directing the section 413(c) plan administrator to spin off the assets and account balances held on behalf of its employees to a separate single-employer plan established and maintained by the employer, the section 413(c) plan administrator must implement and complete a spinoff of the assets and account balances held on behalf of the employees of the employer that are attributable to their employment by the employer within 180 days of the date on which the unresponsive participating employer initiates the spinoff. The section 413(c) plan administrator must report the spinoff to the IRS (in the manner prescribed by the IRS in forms, instructions, and other guidance).

(7) *Spinoff-termination*—(i) *Spinoff*. If the unresponsive participating employer neither takes appropriate remedial action described in paragraph (g)(5)(ii) of this section nor initiates a spinoff pursuant to paragraph (g)(5)(iii) of this section, then, in accordance with plan language, the section 413(c) plan administrator must take the following steps as soon as reasonably practicable after the deadline described in paragraph (g)(5)(i) of this section—

(A) Send notification of spinoff-termination to participants who are employees of the unresponsive participating employer (and their beneficiaries) as described in paragraph (g)(7)(iii) of this section;

(B) Stop accepting contributions from the unresponsive participating employer;

(C) Implement a spinoff, in accordance with the transfer requirements of section 414(l) and the anti-cutback requirements of section 411(d)(6), of the plan assets and account balances held on behalf of employees of the unresponsive participating employer that are attributable to their employment by that employer to a separate single-employer plan and trust that has the same plan administrator, trustee, and substantive plan terms as the section 413(c) plan; and

(D) Terminate the spun-off plan and distribute assets of the spun-off plan to plan participants (and their beneficiaries) as soon as reasonably practicable after the plan termination date.

(ii) *Termination of spun-off plan*. In terminating the spun-off plan, the section 413(c) plan administrator must—

(A) Reasonably determine whether, and to what extent, the survivor annuity requirements of sections 401(a)(11) and 417 apply to any benefit payable under the plan and take reasonable steps to comply with those requirements (if applicable);

(B) Provide each participant and beneficiary with a nonforfeitable right to his or her accrued benefits as of the date of plan termination, subject to income, expenses, gains, and losses between that date and the date of distribution; and

(C) Notify the participants and beneficiaries of their rights under section 402(f).

(iii) *Contents of the notification of spinoff-termination*. For the notice required to be provided in paragraph (g)(7)(i)(A), the section 413(c) plan administrator must provide information relating to the spinoff-termination to participants who are employees of the unresponsive participating employer (and their beneficiaries), including the following—

(A) Identification of the section 413(c) plan and contact information for the section 413(c) plan administrator;

(B) The effective date of the spinoff-termination;

(C) A statement that no more contributions will be made to the section 413(c) plan;

(D) A statement that as soon as practicable after the spinoff-termination, participants and beneficiaries will receive a distribution from the spun-off plan; and

(E) A statement that before the distribution occurs, participants and beneficiaries will receive additional information about their options with respect to that distribution.

(iv) *Reporting spinoff-termination*. The section 413(c) plan administrator must report a spinoff-termination pursuant to this paragraph (g)(7) to the IRS (in the manner prescribed by the IRS in forms, instructions, and other guidance).

(8) *Other rules*—(i) *Form of notices*. Any notice provided pursuant to paragraph (g)(4) or (g)(7)(i)(A) of this section may be provided in writing or in electronic form. For notices provided to participants and beneficiaries, see generally §1.401(a)–21 for rules permitting the use of electronic media to provide applicable notices to recipients with respect to retirement plans.

(ii) *Qualification of spun-off plan*—(A) *In general*. In the case of any plan that is spun off in accordance with paragraph (g)(6)(ii) or (g)(7) of this section, any participating employer failure that would have affected the qualification of the section 413(c) plan, but for the application of the exception set forth in paragraph (g)(2) of this section, will be a qualification failure with respect to the spun-off plan.

(B) *Favorable tax treatment upon termination*. Notwithstanding paragraph (g)(8)(ii)(A) of this section, distributions made from a spun-off plan that is terminated in accordance with paragraph (g)(7) of this section will not, solely because of the participating employer failure, fail to be eligible for favorable tax treatment accorded to distributions from qualified plans (including that the distributions will be treated as eligible rollover distributions under section 402(c)(4)), except as provided in paragraph (g)(8)(ii)(C) of this section.

(C) *Exception for responsible parties*. The IRS reserves the right to pursue appropriate remedies under the Code against any party (such as the owner of the participating employer) who is responsible for the participating employer failure. The IRS may pursue appropriate remedies against a responsible party even in the party's capacity as a participant or beneficiary under the spun-off plan that is terminated in accordance with paragraph (g)(7) of this section (such as by not treating a plan distribution made to the responsible party as an eligible rollover distribution).

(iii) *Additional guidance*. The Commissioner may provide additional guidance in revenue rulings, notices, or other guidance published in the Internal Revenue Bulletin, or in forms and instructions, that the Commissioner determines to be necessary or appropriate with respect to the requirements of this paragraph (g).

(9) *Applicability date*. This paragraph (g) applies on or after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**.

Kirsten Wielobob,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on July 2, 2019, 8:45 a.m. and published in the issue of the Federal Register for July 3, 2019, 84 F.R. 31777)

Definition of Terms

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

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

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

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

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

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

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

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

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

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

Abbreviations

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

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

Numerical Finding List[1]

Bulletin 2019–30

Announcements:

Notices:

Proposed Regulations:

Revenue Rulings:

Revenue Procedures:

Treasury Decisions:

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

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

Bulletin 2019–30

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

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The Introduction at the beginning of this issue describes the purpose and content of this publication. The weekly Internal Revenue Bulletins are available at *www.irs.gov/irb/*.

We Welcome Comments About the Internal Revenue Bulletin

If you have comments concerning the format or production of the Internal Revenue Bulletin or suggestions for improving it, we would be pleased to hear from you. You can email us your suggestions or comments through the IRS Internet Home Page *www.irs.gov*) or write to the Internal Revenue Service, Publishing Division, IRB Publishing Program Desk, 1111 Constitution Ave. NW, IR-6230 Washington, DC 20224.