

INTERNAL REVENUE BULLETIN



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.

Bulletin No. 2021-2
January 11, 2021

ADMINISTRATIVE

T.D. 9940, page 311.

The final regulations describe the procedures used by the IRS to handle misdirected direct deposits of tax refunds. The procedures describe the reporting, identification, and recovery processes used for misdirected direct deposit refunds. The procedures described in the final regulations may be used by any taxpayer whose refund was disbursed as a direct deposit but the taxpayer believes is missing.

EMPLOYEE PLANS

Notice 2021-03, page 316.

This notice provides a 6-month extension of the relief provided in Notice 2020-42. For the period from January 1, 2021, through June 30, 2021, this notice extends two types of relief from the physical presence requirement in § 1.401(a)-21(d)(6)(i) for participant elections required to be witnessed by a plan representative or a notary public: (1) temporary relief from the physical presence requirement for any participant election witnessed by a notary public in a state that permits remote notarization (either by law or through an executive order), and (2) temporary relief from the physical presence requirement for any participant election witnessed by a plan representative. This temporary relief is extended in order to further accommodate local shutdowns and social distancing practices in response to the Coronavirus Disease 2019 pandemic (COVID-19 Emergency). This notice also solicits comments on the relief.

EXCISE TAX

Notice 2021-04, page 319.

Notice 2021-04 provides the final extension of the temporary dyed fuel relief provided in section 3.02 of Notice 2017-30, 2017-21 I.R.B. 1248. The temporary relief was extended

through December 31, 2018, by section 3 of Notice 2018-39, 2018-20, I.R.B. 582, then extended through December 31, 2019, by section 3 of Notice 2019-04, 2019-02 I.R.B. 282, and further extended through December 31, 2020, by section 3 of Notice 2020-04, 2020-04 I.R.B. 380. A claimant may submit a refund claim for the § 4081(a)(1) tax imposed on undyed diesel fuel and kerosene for fuel that is (1) removed from a Milwaukee or Madison terminal; (2) entered into a Green Bay terminal within 24 hours; and (3) subsequently dyed and removed from that Green Bay terminal. The relief provided in this notice takes effect beginning January 1, 2021, and ending December 31, 2021.

REG-130081-19, page 321.

These final rules regarding grandfathered group health plans and grandfathered group health insurance coverage amend the current rules to provide greater flexibility for certain grandfathered health plans to make changes to certain types of cost-sharing requirements without causing a loss of grandfather status.

EXEMPT ORGANIZATIONS

Notice 2021-01, page 315.

This notice provides that, while subject to a delay, private foundations must electronically file Form 4720, Return of Certain Excise Taxes Under Chapters 41 and 42 of the Internal Revenue Code, as required by section 3101 of the Taxpayer First Act of 2019 (Pub. L. No. 116-25) amendments to section 6033 of the Internal Revenue Code. Private foundations may no longer rely on Treas. Reg. § 53.6011-1(c) as a result of this electronic filing mandate.

INCOME TAX

Rev. Rul. 2021-01, page 294.

Federal rates; adjusted federal rates; adjusted federal long-term rate, and the long-term tax exempt rate. For purposes

of sections 382, 1274, 1288, 7872 and other sections of the Code, tables set forth the rates for January 2021.

T.D. 9925, page 296.

These final regulations provide guidance under section 274 of the Internal Revenue Code (Code) regarding certain amendments made to section 274 by the Tax Cuts and Jobs Act of 2017 (TCJA). These final regulations address

the elimination of the deduction under section 274 for entertainment expenses paid or incurred in taxable years beginning after December 31, 2017. The final regulations provide guidance to distinguish entertainment expenses from meal and beverage expenses and address the application of certain exceptions under section 274(e) that may allow such expenses to be deductible. These final regulations affect taxpayers who pay or incur expenses for meal and entertainment expenses.

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.

The contents of this publication are not copyrighted and may be reprinted freely. A citation of the Internal Revenue Bulletin as the source would be appropriate.

Part I

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

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

Rev. Rul. 2021-1

This revenue ruling provides various prescribed rates for federal income tax purposes for January 2021 (the current

month). Table 1 contains the short-term, mid-term, and long-term applicable federal rates (AFR) for the current month for purposes of section 1274(d) of the Internal Revenue Code. Table 2 contains the short-term, mid-term, and long-term adjusted applicable federal rates (adjusted AFR) for the current month for purposes of section 1288(b). Table 3 sets forth the adjusted federal long-term rate and the long-term tax-exempt rate described in section 382(f). Table 4 contains the appropriate percentages for determining the low-income housing credit described in section 42(b)(1) for buildings placed in service during the current month. However,

under section 42(b)(2), the applicable percentage for non-federally subsidized new buildings placed in service after July 30, 2008, shall not be less than 9%. Table 5 contains the federal rate for determining the present value of an annuity, an interest for life or for a term of years, or a remainder or a reversionary interest for purposes of section 7520. Finally, Table 6 contains the deemed rate of return for transfers made during calendar year 2021 to pooled income funds described in section 642(c) (5) that have been in existence for less than 3 taxable years immediately preceding the taxable year in which the transfer was made.

REV. RUL. 2021-1 TABLE 1
Applicable Federal Rates (AFR) for January 2021
Period for Compounding

| | <i>Annual</i> | <i>Semiannual</i> | <i>Quarterly</i> | <i>Monthly</i> |
|----------|---------------|-------------------|------------------|----------------|
| | | <i>Short-term</i> | | |
| AFR | 0.14% | 0.14% | 0.14% | 0.14% |
| 110% AFR | 0.15% | 0.15% | 0.15% | 0.15% |
| 120% AFR | 0.17% | 0.17% | 0.17% | 0.17% |
| 130% AFR | 0.18% | 0.18% | 0.18% | 0.18% |
| | | <i>Mid-term</i> | | |
| AFR | 0.52% | 0.52% | 0.52% | 0.52% |
| 110% AFR | 0.57% | 0.57% | 0.57% | 0.57% |
| 120% AFR | 0.62% | 0.62% | 0.62% | 0.62% |
| 130% AFR | 0.68% | 0.68% | 0.68% | 0.68% |
| 150% AFR | 0.78% | 0.78% | 0.78% | 0.78% |
| 175% AFR | 0.91% | 0.91% | 0.91% | 0.91% |
| | | <i>Long-term</i> | | |
| AFR | 1.35% | 1.35% | 1.35% | 1.35% |
| 110% AFR | 1.50% | 1.49% | 1.49% | 1.49% |
| 120% AFR | 1.63% | 1.62% | 1.62% | 1.61% |
| 130% AFR | 1.77% | 1.76% | 1.76% | 1.75% |

REV. RUL. 2021-1 TABLE 2
Adjusted AFR for January 2021
Period for Compounding

| | <i>Annual</i> | <i>Semiannual</i> | <i>Quarterly</i> | <i>Monthly</i> |
|-------------------------|---------------|-------------------|------------------|----------------|
| Short-term adjusted AFR | 0.11% | 0.11% | 0.11% | 0.11% |
| Mid-term adjusted AFR | 0.39% | 0.39% | 0.39% | 0.39% |
| Long-term adjusted AFR | 1.03% | 1.03% | 1.03% | 1.03% |

REV. RUL. 2021-1 TABLE 3

Rates Under Section 382 for January 2021

| | |
|--|-------|
| Adjusted federal long-term rate for the current month | 1.03% |
| Long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months.) | 1.03% |

REV. RUL. 2021-1 TABLE 4

Appropriate Percentages Under Section 42(b)(1) for January 2021

Note: Under section 42(b)(2), the applicable percentage for non-federally subsidized new buildings placed in service after July 30, 2008, shall not be less than 9%.

| | |
|--|-------|
| Appropriate percentage for the 70% present value low-income housing credit | 7.21% |
| Appropriate percentage for the 30% present value low-income housing credit | 3.09% |

REV. RUL. 2021-1 TABLE 5

Rate Under Section 7520 for January 2021

| | |
|---|-----|
| Applicable federal rate for determining the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest | .6% |
|---|-----|

REV. RUL. 2021-1 TABLE 6

Deemed Rate for Transfers to New Pooled Income Funds During 2021

| | |
|--|------|
| Deemed rate of return for transfers during 2021 to pooled income funds that have been in existence for less than 3 taxable years | 2.2% |
|--|------|

Section 42.—Low-Income Housing Credit

The applicable federal short-term, mid-term, and long-term rates are set forth for the month of January 2021. See Rev. Rul. 2021-1, page 294.

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

The applicable federal short-term, mid-term, and long-term rates are set forth for the month of January 2021. See Rev. Rul. 2021-1, page 294.

Section 483.—Interest on Certain Deferred Payments

The applicable federal short-term, mid-term, and long-term rates are set forth for the month of January 2021. See Rev. Rul. 2021-1, page 294.

Section 280G.—Golden Parachute Payments

The applicable federal short-term, mid-term, and long-term rates are set forth for the month of January 2021. See Rev. Rul. 2021-1, page 294.

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

The applicable federal short-term rates are set forth for the month of January 2021. See Rev. Rul. 2021-1, page 294.

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

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of January 2021. See Rev. Rul. 2021-1, page 294.

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

The adjusted applicable federal long-term rate is set forth for the month of January 2021. See Rev. Rul. 2021-1, page 294.

Section 482.—Allocation of Income and Deductions Among Taxpayers

The applicable federal short-term, mid-term, and long-term rates are set forth for the month of January 2021. See Rev. Rul. 2021-1, page 294.

Section 7520.—Valuation Tables

The applicable federal mid-term rates are set forth for the month of January 2021. See Rev. Rul. 2021-1, page 294.

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

The applicable federal short-term, mid-term, and long-term rates are set forth for the month of January 2021. See Rev. Rul. 2021-1, page 294.

Announcement Correcting TD 9925

26 CFR 1.274-11; 26 CFR 1.274-12

T.D. 9925

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

Meals and Entertainment Expenses Under Section 274; Correction

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations; correction.

SUMMARY: This document contains corrections to the final regulations (Treasury Decision 9925) that published in the Federal Register on October 9, 2020. The final regulations provide guidance under section 274 of the Internal Revenue Code (Code) regarding certain recent amendments made to that section. Specifically, the final regulations address the elimination of the deduction under section 274 for expenditures related to entertainment, amusement, or recreation activities, and provide guidance to determine whether an activity is of a type generally considered to be entertainment.

DATES: These corrections are effective on December 18, 2020 and applicable for taxable years that begin on or after October 9, 2020.

FOR FURTHER INFORMATION CONTACT: Patrick Clinton of the Office of the Associate Chief Counsel (Income Tax and Accounting), (202) 317-7005 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

The final regulations (TD 9925) that are the subject of this correction are issued

under section 274 of the Internal Revenue Code.

Need for Correction

As published the final regulations (TD 9925) contain errors that need to be corrected.

Correction of Publication

Accordingly, the final regulations (TD 9925), that are the subject of FR Doc. 2020-21990, published on October 9, 2020 (85 FR 64026), are corrected as follows:

1. On page 64031, third column, the second line, the language “in *Sutherland Lumber*” is corrected to read “in *Sutherland Lumber-Southwest*”.

2. On page 64031, third column, the ninth line of the second full paragraph, the language “§ 1.274-10(a)(2)(ii)(C)(2)” is corrected to read “§ 1.274-10(a)(2)(ii)(C)(2)”.

3. On page 64032, second column, the second line, the language “or gross income is zero, whether zero is” is corrected to read “or gross income is zero (other than due to a reimbursement by the recipient), whether zero is”.

4. On page 64032, second column, the thirteenth line from the top of the page, the language “(e)(9) do not apply.” is corrected to read “(e)(9) generally do not apply.”.

5. On page 64032, second column, the thirteenth line from the top of the page, the language “Similarly, the exceptions in section 274(e)(2) and (e)(9) do not apply if” is corrected to read “However, the exceptions in section 274(e)(2) and (e)(9) will apply if the recipient reimburses the taxpayer for a portion of the value of the food or beverages even if the value exceeding the reimbursed amount is properly excluded from the recipient’s compensation and wages or gross income. In this case, however, the taxpayer must apply the dollar-for-dollar rule as described in § 1.274-12(c)(2)(i)(D). In cases in which”.

6. On page 64032, second column, the second and last sentence from the bottom of the first partial paragraph, remove the language “. In that case, however,”.

7. On page 64032, third column, the third line of the second full paragraph, the

language “regulations confirm” is corrected to read “regulations confirmed”.

8. On page 64032, third column, the twelfth line of the second full paragraph, the language “demonstrates” is corrected to read “demonstrated”.

Crystal Pemberton,
Senior Federal Register Liaison,
Publications and Regulations Branch,
Legal Processing Division,
Associate Chief Counsel,
(Procedure and Administration).

(Filed by the Office of the Federal Register on December 17, 2020, 8:45 a.m., and published in the issue of the Federal Register for December 18, 2020, 85 F.R. 82355)

Section 274. — Disallowance of Certain Entertainment, Gift and Travel Expenses

26 CFR 1.274-1-11, 12: *Meals and Entertainment Expenses.*

T.D. 9925

DEPARTMENT OF TREASURY Internal Revenue Service 26 CFR Part 1

Meals and Entertainment Expenses

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final rule.

SUMMARY: This document contains final regulations that provide guidance under section 274 of the Internal Revenue Code (Code) regarding certain recent amendments made to that section. Specifically, the final regulations address the elimination of the deduction under section 274 for expenditures related to entertainment, amusement, or recreation activities, and provide guidance to determine whether an activity is of a type generally consid-

ered to be entertainment. The final regulations also address the limitation on the deduction of food and beverage expenses under section 274(k) and (n), including the applicability of the exceptions under section 274(e)(2), (3), (4), (7), (8), and (9). The final regulations affect taxpayers who pay or incur expenses for meals or entertainment.

DATES: *Effective Date:* These regulations are effective on October 9, 2020.

Applicability Date: These regulations apply for taxable years that begin on or after October 9, 2020.

FOR FURTHER INFORMATION CONTACT: Patrick Clinton of the Office of the Associate Chief Counsel (Income Tax and Accounting), (202) 317-7005 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains final regulations under section 274 of the Code that amend the Income Tax Regulations (26 CFR part 1). In general, section 274 limits or disallows deductions for certain meal and entertainment expenditures that otherwise would be allowable under chapter 1 of the Code (chapter 1), primarily under section 162(a), which allows a deduction for ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business.

On December 22, 2017, section 274 was amended by section 13304 of Public Law 115-97 (131 Stat. 2054), commonly referred to as the Tax Cuts and Jobs Act, (TCJA) to revise the rules for deducting expenditures for meals and entertainment, effective for amounts paid or incurred after December 31, 2017.

On February 26, 2020, the Department of the Treasury (Treasury Department) and the IRS published a notice of proposed rulemaking (REG-100814-19) in the **Federal Register** (85 FR 11020) containing proposed regulations under section 274 to implement certain of the TCJA's amendments to section 274 (proposed regulations). The proposed regulations would update existing regulations in §1.274-2

by adding a new section at §1.274-11 for entertainment expenditures. The proposed regulations would also add a new section at §1.274-12 to address the limitations on food or beverage expenses under section 274(k) and (n), including the application of the exceptions in section 274(e)(2), (3), (4), (7), (8), and (9). Pending the issuance of these final regulations, taxpayers were permitted to rely upon the proposed regulations for entertainment and food or beverage expenses, as applicable, paid or incurred after December 31, 2017.

The Treasury Department and the IRS did not receive any requests to speak at a public hearing on the proposed regulations. Therefore, the scheduled public hearing was cancelled. The Treasury Department and the IRS received 14 written and electronic comments in response to the proposed regulations. All comments were considered and are available at <https://www.regulations.gov> or upon request. The comments addressing the proposed regulations are summarized in the Summary of Comments and Explanation of Revisions section. However, comments recommending statutory revisions or addressing issues outside the scope of these final regulations are not discussed in this preamble. After full consideration of the comments, this Treasury decision adopts the proposed regulations with modifications in response to certain comments, as described in the Summary of Comments and Explanation of Revisions section.

1. Business Meals and Entertainment

Section 274(a)(1)(A) generally disallows a deduction for any item with respect to an activity of a type considered to constitute entertainment, amusement, or recreation (entertainment expenditures). However, prior to the amendment by the TCJA, section 274(a)(1)(A) provided exceptions to that disallowance if the taxpayer established that: (1) the item was directly related to the active conduct of the taxpayer's trade or business (directly related exception); or (2) in the case of an item directly preceding or following a substantial and bona fide business discussion (including business meetings at a convention or otherwise), the item was associated with the active conduct of the taxpayer's trade or business (business

discussion exception). Section 274(e)(1) through (9) also provide exceptions to the rule in section 274(a) that disallows a deduction for entertainment expenditures. The TCJA did not change the application of the section 274(e) exceptions to entertainment expenditures.

Section 274(a)(1)(B) disallows a deduction for any item with respect to a facility used in connection with an activity referred to in section 274(a)(1)(A). Section 274(a)(2) provides that, for purposes of applying section 274(a)(1), dues or fees to any social, athletic, or sporting club or organization shall be treated as items with respect to facilities. Section 274(a)(3) disallows a deduction for amounts paid or incurred for membership in any club organized for business, pleasure, recreation, or other social purpose.

Prior to amendment by the TCJA, section 274(n)(1) generally limited the deduction of food or beverage expenses and entertainment expenditures to 50 percent of the amount that otherwise would have been allowable. Thus, under prior law, taxpayers could deduct 50 percent of meal expenses, and 50 percent of entertainment expenditures that met the directly related or business discussion exception. Distinguishing between meal expenses and entertainment expenditures was unnecessary for purposes of the 50 percent limitation.

Section 13304(a)(1) of the TCJA repealed the directly related and business discussion exceptions to the general prohibition on deducting entertainment expenditures in section 274(a)(1)(A). Also, section 13304(a)(2)(D) of the TCJA amended the 50 percent limitation in section 274(n)(1) to remove the reference to entertainment expenditures. Thus, entertainment expenditures are no longer deductible unless one of the nine exceptions to section 274(a) in section 274(e) applies.

While the TCJA eliminated the deduction for entertainment expenses, Congress did not amend the provisions relating to the deductibility of business meals. Thus, taxpayers generally may continue to deduct 50 percent of the food and beverage expenses associated with operating their trade or business, including meals consumed by employees on work travel. See H.R. Rep. No. 115-466, at 407 (2017) (Conf. Rep.). However, as before the TCJA, no deduction is allowed for the

expense of any food or beverages unless (a) the expense is not lavish or extravagant under the circumstances, and (b) the taxpayer (or an employee of the taxpayer) is present at the furnishing of the food or beverages. See section 274(k).

Prior to amendment by the TCJA, section 274(d) provided substantiation requirements for deductions under section 162 or 212 for any traveling expense (including meals and lodging while away from home), and for any item with respect to an activity of a type considered to constitute entertainment, amusement, or recreation or with respect to a facility used in connection with such activity. Section 13304(a)(2)(A) of the TCJA repealed the substantiation requirements for entertainment expenditures. Traveling expenses (including meals and lodging while away from home), however, remain subject to the section 274(d) substantiation requirements. Food and beverage expenses are subject to the substantiation requirements under section 162 and the requirement to maintain books and records under section 6001.

On October 15, 2018, the Treasury Department and the IRS published Notice 2018-76, 2018-42 I.R.B. 599, providing transitional guidance on the deductibility of expenses for certain business meals and requesting comments for future guidance to further clarify the treatment of business meal expenses and entertainment expenditures under section 274. Under the notice, taxpayers may deduct 50 percent of an otherwise allowable business meal expense if: (1) the expense is an ordinary and necessary expense under section 162(a) paid or incurred during the taxable year in carrying on any trade or business; (2) the expense is not lavish or extravagant under the circumstances; (3) the taxpayer, or an employee of the taxpayer, is present at the furnishing of the food or beverages; (4) the food and beverages are provided to a current or potential business customer, client, consultant, or similar business contact; and (5) in the case of food and beverages provided at or during an entertainment activity, the food and beverages are purchased separately from the entertainment, or the cost of the food and beverages is stated separately from the cost of the entertainment on one or more bills, invoices, or receipts. The notice provides

that the entertainment disallowance rule may not be circumvented through inflating the amount charged for food and beverages.

2. Travel Meals

Section 274(n)(1) generally limits the deduction of food or beverage expenses, including expenses for food or beverages consumed while away from home, to 50 percent of the amount that otherwise would have been allowable, unless one of the six exceptions to section 274(n) in section 274(e) applies. However, no deduction is allowed for the expense of any food or beverages unless: (1) the expense is not lavish or extravagant under the circumstances; and (2) the taxpayer (or an employee of the taxpayer) is present at the furnishing of the food or beverages. See section 274(k). Section 274(d) provides substantiation requirements for traveling expenses, including food and beverage expenses incurred while on business travel away from home.

Section 274(m) provides additional limitations on travel expenses, including expenses for meals consumed while away from home. Section 274(m)(1) generally limits the deduction for luxury water transportation expenses to twice the highest federal per diem rate allowable at the time of travel, and section 274(m)(2) generally disallows a deduction for expenses for travel as a form of education. Section 274(m)(3) provides that no deduction is allowed under chapter 1 (other than section 217) for travel expenses paid or incurred with respect to a spouse, dependent, or other individual accompanying the taxpayer (or an officer or employee of the taxpayer) on business travel, unless: (1) the spouse, dependent, or other individual is an employee of the taxpayer; (2) the travel of the spouse, dependent, or other individual is for a bona fide business purpose; and (3) such expenses would otherwise be deductible by the spouse, dependent, or other individual.

3. Employer-Provided Meals

Prior to amendment by the TCJA, section 274(n)(1) generally limited the deduction for food or beverage expenses

to 50 percent of the amount that otherwise would have been allowable, subject to an exception in section 274(n)(2)(B) in the case of an expense for food or beverages that is excludable from the gross income of the recipient under section 132 by reason of section 132(e), relating to *de minimis* fringes. Section 132(e)(1) defines “*de minimis* fringe” as any property or service the value of which is, after taking into account the frequency with which similar fringes are provided by the employer to its employees, so small as to make accounting for it unreasonable or administratively impracticable. Section 132(e)(2) provides that the operation by an employer of any eating facility for employees is treated as a *de minimis* fringe if (1) the facility is located on or near the business premises of the employer, and (2) revenue derived from the facility normally equals or exceeds the direct operating costs of the facility. Thus, under prior law, employers generally were allowed to fully deduct an expense for food or beverages provided to their employees if the amount was excludable from the gross income of the employee as a *de minimis* fringe. However, the TCJA repealed section 274(n)(2)(B), meaning that expenses for food or beverages that are *de minimis* fringes under section 132(e) are no longer excepted from section 274(n)(1). As a result, these expenses, like other food or beverage expenses generally, are subject to the 50 percent limitation unless one of the six exceptions to section 274(n) in section 274(e) applies.

The TCJA also added section 274(o) that, effective for amounts paid or incurred after December 31, 2025, disallows a deduction for (1) any expense for the operation of an employer-operated facility described in section 132(e)(2), and any expense for food or beverages, including under section 132(e)(1), associated with such facility, or (2) any expense for meals provided to an employee for the convenience of the employer, as described in section 119(a). Thus, beginning with amounts paid or incurred in 2026, expenses for food or beverages provided to employees, as well as expenses for the operation of certain eating facilities for employees, will be fully nondeductible.

4. Section 274(e) Exceptions to Section 274(k) and (n)

Section 274(k)(2)(A) and (n)(2)(A) provide that the limitations on the deduction of food or beverage expenses in section 274(k)(1) and (n)(1), respectively, do not apply if the expense is described in paragraph (2), (3), (4), (7), (8), or (9) of section 274(e). Expenses described in paragraph (1), (5), and (6) of section 274(e) are not exceptions to the limitations on the deduction of food or beverage expenses in section 274(k)(1) and (n)(1). However, they are exceptions to the disallowance of the deduction of entertainment expenses in section 274(a).

Section 274(e)(2) applies to expenses for goods, services, and facilities to the extent that the expenses are treated as compensation to the recipient. Section 274(e)(3) applies to expenses incurred by a taxpayer in connection with the performance of services for an employer or other person under a reimbursement or other expense allowance arrangement. Section 274(e)(4) applies to expenses for recreational, social, or similar activities for employees. Section 274(e)(7) applies to expenses for goods, services, and facilities made available to the general public. Section 274(e)(8) applies to expenses for goods or services that are sold by the taxpayer in a bona fide transaction for an adequate and full consideration in money or money's worth. Section 274(e)(9) applies to expenses for goods, services, and facilities to the extent that the expenses are treated as income to a person other than an employee.

Summary of Comments and Explanation of Revisions

1. Entertainment Expenditures

The final regulations restate the statutory rules under section 274(a), at § 1.274-11(a), including the application of the entertainment deduction disallowance rule to dues or fees to any social, athletic, or sporting club or organization. The existing definition of entertainment in § 1.274-2(b)(1), with minor modifications to remove outdated language, is incorporated into the final regulations, at § 1.274-11(b)(1). The final regulations provide that for pur-

poses of section 274(a), the term "entertainment" does not include food or beverages unless the food or beverages are provided at or during an entertainment activity and the costs of the food or beverages are not separately stated from the entertainment costs. The final regulations do not affect the application of the special rules in § 1.274-10 to expenses related to aircraft used for entertainment.

A. Section 274(e) Exceptions to Section 274(a)

The final regulations, at § 1.274-11(c), confirm the continued application of the nine exceptions in section 274(e) to entertainment expenditures otherwise disallowed by section 274(a). The application of section 274(e) to food or beverage expenses is discussed in part 2.E. of this Summary of Comments and Explanation of Revisions section, which discusses the exceptions under section 274(e) to section 274(k) and (n).

A commenter on the proposed regulations requested that the Treasury Department and the IRS clarify that for purposes of the section 274(e)(8) exception to the entertainment deduction limitations in section 274(a) for goods or services sold by the taxpayer, the goods or services may be sold to an employee of the taxpayer in a bona fide transaction for an adequate and full consideration in money or money's worth. The Treasury Department and the IRS decline to adopt this suggestion because the section 274(e)(8) exception to the entertainment disallowance is outside the scope of these regulations. The proposed regulations and these final regulations were initiated in response to the changes made to section 274 by the TCJA and generally are limited to addressing those changes. In particular, with regard to entertainment expenditures, the final regulations under § 1.274-11 primarily distinguish between meals and entertainment, as that distinction is now relevant, for purposes of determining whether the deduction of a particular expense is disallowed entirely or is limited to 50 percent. However, the TCJA did not change the application of the section 274(e) exceptions to entertainment expenditures. Thus, other than confirming that the section 274(e) exceptions continue to apply to

entertainment expenditures, the final regulations do not provide rules addressing how the section 274(e) exceptions apply to entertainment expenditures. Taxpayers may, however, continue to rely upon the existing rules and examples in § 1.274-2 to the extent they are not superseded by the TCJA or other legislation and are not inconsistent with the final regulations.

B. Separately Stated Food or Beverages not Entertainment

The final regulations substantially incorporate the guidance in Notice 2018-76 to distinguish between entertainment expenditures and food or beverage expenses in the context of business meals provided at or during an entertainment activity. In addition, the final regulations generally apply the guidance in Notice 2018-76 to all food or beverages, including travel meals and employer-provided meals, provided at or during an entertainment activity. The final regulations also clarify the rules applicable to food or beverages provided at or during an entertainment activity.

Notice 2018-76 explains that in the case of food and beverages provided at or during an entertainment activity, the taxpayer may deduct 50 percent of an otherwise allowable business expense if the food and beverages are purchased separately from the entertainment, or if the cost of the food and beverages is stated separately from the cost of the entertainment on one or more bills, invoices, or receipts. The notice provides that the entertainment disallowance rule may not be circumvented through inflating the amount charged for food and beverages. The final regulations clarify this requirement by providing that the amount charged for food or beverages on a bill, invoice, or receipt must reflect the venue's usual selling cost for those items if they were to be purchased separately from the entertainment, or must approximate the reasonable value of those items.

The final regulations provide that in cases where the food or beverages provided at or during an entertainment activity are not purchased separately from the entertainment, and where the cost of the food or beverages is not stated separately from the cost of the entertainment on

one or more bills, invoices, or receipts, no allocation can be made and the entire amount is a nondeductible entertainment expenditure. Finally, in accordance with the TCJA's amendments to section 274(a) (1) specifically repealing the "directly related" and "business discussion" exceptions to the general disallowance rule for entertainment expenditures, the final regulations clarify that the entertainment disallowance rule applies whether or not the expenditure for the activity is related to or associated with the active conduct of the taxpayer's trade or business.

A commenter suggested that the final regulations provide that the consumption of food and beverages is not entertainment in the case of both business and nonbusiness activities and include an example of a specified individual consuming food and beverages while traveling on an employer-provided aircraft to visit family members for nonbusiness purposes. The specific question presented in this comment relates to whether air travel is an entertainment activity and is addressed in the existing rules in §1.274-10. Therefore, this question is not addressed in the final regulations. In addition, §1.274-11(b)(1) (ii) provides that the term *entertainment* does not include food or beverages unless the food or beverages are provided at or during an entertainment activity and are not purchased separately from the entertainment.

2. Food or Beverage Expenses

A. Business Meal Expenses

The final regulations substantially incorporate the guidance in Notice 2018-76 addressing business meals provided at or during an entertainment activity. The final regulations also incorporate other statutory requirements taxpayers must meet to deduct 50 percent of an otherwise allowable food or beverage expense. Specifically, the expense must not be lavish or extravagant under the circumstances, and the taxpayer, or an employee of the taxpayer, must be present at the furnishing of the food or beverages.

The final regulations also address the general requirement in Notice 2018-76 that the food and beverages be provided to a business contact, which was described in

the notice as a "current or potential business customer, client, consultant, or similar business contact." This requirement is to ensure that the meal expenses are directly connected with or pertaining to the taxpayer's trade or business, as required under section 162. One commenter on Notice 2018-76 requested a definition of "potential business contact," suggesting that the term could be interpreted broadly to include almost anyone. In response to the comment, and to conform the rule more closely to the trade or business requirement in section 162, the proposed regulations follow the definition of "business associate" as currently provided in §1.274-2(b)(2)(iii). The final regulations adopt this definition of "business associate" in §1.274-12(b)(3). Thus, the final regulations provide that the food or beverages must be provided to a "person with whom the taxpayer could reasonably expect to engage or deal in the active conduct of the taxpayer's trade or business such as the taxpayer's customer, client, supplier, employee, agent, partner, or professional adviser, whether established or prospective." Accordingly, the final regulations apply this definition to employer-provided food or beverage expenses by considering employees as a type of business associate as well as to the deduction for expenses for meals provided by a taxpayer to both employees and non-employee business associates at the same event.

A commenter on the proposed regulations asked whether the Treasury Department and the IRS have legal authority to allow taxpayers to claim deductions for business meal expenses that have been considered part of entertainment since the enactment of section 274. The commenter acknowledged that the legislative history of the TCJA provides that taxpayers may still generally deduct 50 percent of the food and beverage expenses associated with operating their trade or business (e.g., meals consumed by employees on work travel). H.R. Rep. No. 115-466 at 407. However, the commenter argued that the legislative history merely recognizes that travel meals remain 50 percent deductible. The commenter further argued that the term "entertainment" clearly encompasses many business meals and that the proposed regulations unsettle the long-standing position that expenditures for the

personal enjoyment of an individual fall within the ordinary meaning of "entertainment."

The Treasury Department and the IRS believe that Congress, in amending section 274 in the TCJA, intended that expenses for business meals be considered food or beverage expenses associated with operating a taxpayer's trade or business, and therefore generally remain 50 percent deductible. The Treasury Department and the IRS acknowledge that, prior to the TCJA, some meals were considered to be entertainment. However, prior to the TCJA, neither section 274 nor the regulations under section 274 attempted to define meal expenses or to distinguish meal expenses from entertainment expenses. In considering the comment, the Treasury Department and the IRS believe that the proposed regulations are consistent with the plain reading of section 274 after the TCJA, which clearly contemplates different treatment for meal expenses and entertainment expenses. In addition, the existing regulatory definition of entertainment relies upon an objective test to determine whether an activity is of a type generally considered to constitute entertainment. Providing that business meals are not of a type generally considered to constitute entertainment results in an administrable rule that does not depend on subjective factors such as whether the taxpayer enjoys the business meal. Thus, the final regulations adopt the proposed rule providing that business meals generally remain 50 percent deductible. The Treasury Department and the IRS believe that the final regulations provide a rule that is legally supportable and that draws a clear line between meals and entertainment that taxpayers can understand and the IRS can administer.

One commenter also asked whether the proposed regulations were intended to provide new guidance under section 162(a), specifically as to the definition of "ordinary and necessary expense." The proposed regulations provide guidance only under section 274 and are not intended to provide guidance under section 162. In response to the comment, the final regulations modify Examples 1 and 2 in proposed §1.274-12(a)(3) by removing any mention of a discussion that takes place during lunch because the facts al-

ready explain that in each example, the food or beverage expenses are assumed to be ordinary and necessary expenses under section 162(a). In addition, the final regulations clarify, as necessary, in the introductory language to the examples in §1.274-11 and §1.274-12 that the examples assume that the underlying expenses are deductible under section 162.

Two commenters requested that the final regulations add an example addressing the treatment of expenses for food and beverages provided to attendees at a business meeting, such as a conference for clients or a training seminar for employees. In response to these comments, the final regulations add two new examples to §1.274-12(a)(3) to address these scenarios.

A commenter also asked whether under proposed §1.274-12(a), a taxpayer may claim a 50 percent deduction for food or beverages provided to the taxpayer (or an employee of the taxpayer), as well as food or beverages provided to a business associate. The commenter noted that proposed §1.274-12(a)(1) refers to “food or beverages provided to a business associate,” raising a question about whether the rule applies to food or beverages provided to the taxpayer or the taxpayer’s employees. In addition, §1.274-12(a)(1) of the proposed regulations refers to food or beverages provided “to another person or persons.” It was intended that the 50 percent deduction applies to food and beverages provided to the taxpayer (or an employee of the taxpayer), as well as a business associate or another person. In response to the comment, the final regulations revise §1.274-12(a)(1) to remove the reference to food or beverages being provided “to another person or persons.” In addition, as discussed in part 2.A. of this Summary of Comments and Explanation of Revisions, the final regulations include employees in the definition of “business associate” (as defined in §1.274-12(b)(3)). Finally, to make clear that the rules in §1.274-12(a)(1) also apply to food or beverages provided to a taxpayer such as a sole proprietor or other business owner, the final regulations revise §1.274-12(a)(1)(iii) to refer to food or beverages provided “to the taxpayer or a business associate.”

One commenter asked whether a sole proprietor can deduct the cost of meals

when working throughout the day. As explained in the Background section of this preamble, section 274 limits or disallows deductions for certain meal and entertainment expenditures that otherwise would be allowable under chapter 1, primarily under section 162(a), which allows a deduction for ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. The requirements imposed by section 274 are in addition to the requirements for deductibility imposed by other provisions of the Code. If a taxpayer intends to claim a deduction for an expenditure for meals or entertainment, the taxpayer must first establish that the expenditure is otherwise allowable as a deduction under chapter 1 before the provisions of section 274 become applicable. Therefore, the sole proprietor must first establish that the food or beverage expense is deductible under chapter 1 before section 274 would apply. For example, if the sole proprietor can establish that the food or beverage expenses are ordinary and necessary expenses under section 162(a) that are paid or incurred during the taxable year in carrying on a trade or business, the sole proprietor may deduct 50 percent of the food or beverage expenses under section 274(k) and (n) and §1.274-12(a) of the final regulations if: (1) the expenses are not lavish or extravagant; (2) the sole proprietor, or an employee of the sole proprietor, is present at the furnishing of the food or beverages; and (3) the food or beverages are provided to the sole proprietor or a business associate (as defined in §1.274-12(b)(3)).

B. Travel Meal Expenses

Although the TCJA did not specifically amend the rules for travel expenses, the final regulations are intended to provide comprehensive rules for food and beverage expenses and thus, apply the general rules for meal expenses from Notice 2018-76 and the proposed regulations, to travel meals. In addition, the final regulations incorporate the substantiation requirements in section 274(d), unchanged by the TCJA, to travel meals. Finally, the final regulations apply the limitations in section 274(m)(3) to expenses for food or beverages paid or incurred while on travel for spouses, dependents or other individ-

uals accompanying the taxpayer (or an officer or employee of the taxpayer) on business travel. These limitations do not apply to deductions for moving expenses under section 217. However, the TCJA amended section 217 to suspend the deduction for moving expenses for taxable years beginning after December 31, 2017, and before January 1, 2026, except with respect to certain members of the Armed Forces. Thus, the final regulations revise the reference to section 217 to reflect that amendment.

One commenter asked how the proposed regulations affect employees that are paid a per diem rate for travel expenses and are subject to the hours of service limitations of the Department of Transportation. The proposed regulations describe and clarify the statutory requirements of section 274(a), 274(k), and 274(n) for entertainment and food or beverage expenses, as well as the applicability of certain exceptions under section 274(e) to food or beverage expenses. The TCJA did not change the rules for using a per diem rate to substantiate, under section 274(d), the amount of ordinary and necessary business expenses paid or incurred while traveling away from home. Thus, neither the proposed regulations nor the final regulations address the substantiation rules.

C. Other Food or Beverage Expenses

The final regulations apply the business meal guidance in Notice 2018-76, as revised in the proposed regulations, to food or beverage expenses generally. Under section 274(n)(1), the deduction for food or beverage expenses generally is limited to 50 percent of the amount that would otherwise be allowable. Prior to the TCJA, under section 274(n)(2)(B), expenses for food or beverages that were excludable from employee income as *de minimis* fringe benefits under section 132(e) were not subject to the 50 percent deduction limitation under section 274(n)(1) and could be fully deducted. The TCJA repealed section 274(n)(2)(B) so that expenses for food or beverages excludable from employee income under section 132(e) are subject to the section 274(n)(1) deduction limitation unless another exception under section 274(n)(2) applies.

Under section 274(k)(1), in order for food or beverage expenses to be deductible the food or beverages must not be lavish or extravagant under the circumstances and the taxpayer or an employee of the taxpayer must be present at the furnishing of the food or beverages. However, as discussed in the Background section of this preamble, section 274(e) provides six exceptions to the limitations on the deduction of food or beverages in section 274(k)(1) and (n)(1). The final regulations explain how those exceptions apply. The Background section of this preamble also explains that the exceptions in section 274(e)(1), (e)(5), and (e)(6) do not apply to food or beverage expenses. Section 1.274-12(a)(3) of the final regulations adds an example illustrating that the exception in section 274(e)(5) does not apply to food or beverage expenses that are directly related to business meetings of a taxpayer's employees.

In response to comments that the Treasury Department and the IRS received after enactment of the TCJA, the final regulations address several scenarios involving the deductibility of food or beverage expenses. For example, commenters requested guidance on the deductibility of expenses for: (1) food or beverages provided to food service workers who consume the food or beverages while working in a restaurant or catering business; (2) snacks available to employees in a pantry, break room, or copy room; (3) refreshments provided by a real estate agent at an open house; (4) food or beverages provided by a seasonal camp to camp counselors; (5) food or beverages provided to employees at a company cafeteria; and (6) food or beverages provided at company holiday parties and picnics.

D. Definitions

The final regulations provide that the deduction limitation rules generally apply to all food and beverages, whether characterized as meals, snacks, or other types of food or beverage items. In addition, unless one of six exceptions under section 274(e) applies, the deduction limitations apply regardless of whether the food or beverages are treated as *de minimis* fringe benefits under section 132(e).

The final regulations define food or beverage expenses to mean the cost of food or beverages, including any delivery fees, tips, and sales tax. In the case of employer-provided meals at an eating facility, food or beverage expense do not include expenses for the operation of the eating facility such as salaries of employees preparing and serving meals and other overhead costs.

A commenter requested clarification that the cost of transportation to a meal is not included in food or beverage expenses. The Treasury Department and the IRS considered this comment and note that food or beverage expenses under § 1.274-12(b)(2) of the final regulations means the full cost of food or beverages, including any delivery fees, tips, and sales tax. Indirect expenses, including the cost of transportation to a meal, are not included in the definition.

E. Section 274(e) Exceptions to Section 274(k) and (n)

Section 274(k)(2)(A) and (n)(2)(A) provide that the limitations on deductions in section 274(k)(1) and (n)(1), respectively, do not apply to any expense described in section 274(e)(2), (3), (4), (7), (8), and (9). Section 1.274-12(c) of the final regulations, therefore, provides that the deduction limitations are not applicable to expenditures for business meals, travel meals, or other food or beverages that fall within one of these exceptions.

i. Expenses Treated as Compensation under Section 274(e)(2) or (e)(9)

Pursuant to section 274(e)(2), the final regulations provide that the limitations in section 274(k)(1) and (n)(1) do not apply to expenditures for food or beverages provided to an employee of the taxpayer to the extent the taxpayer treats the expenses as compensation to the employee on the taxpayer's income tax return as originally filed, and as wages to the employee for purposes of withholding under chapter 24 of the Code, relating to collection of income tax at source on wages.

Pursuant to section 274(e)(9), the final regulations provide that the limitations in section 274(k)(1) and (n)(1) do not apply to expenses for food or beverages provid-

ed to a person who is not an employee of the taxpayer to the extent the expenses are includible in the gross income of the recipient of the food or beverages as compensation for services rendered or as a prize or award under section 74.

The exceptions in section 274(e)(2) related to employees and in section 274(e)(9) related to non-employees have been interpreted as allowing a taxpayer to deduct the full amount of an expense if the expense has properly been included in the compensation and wages of the employee, or gross income of the recipient, even if the amount of the expense exceeds the amount included in compensation or income. See *Sutherland Lumber-Southwest Inc. v. Commissioner*, 114 T.C. 197 (2000), *aff'd.*, 255 F.3d 495 (8th Cir. 2001), *acq.*, AOD 2002-02 (February 11, 2002). In 2004, Congress reversed the result in the *Sutherland Lumber-Southwest* case by enacting section 274(e)(2)(B) with regard to specified individuals. Thus, with regard to employees or non-employees who are specified individuals, section 274(e)(2)(B) provides an exception to the section 274(n) limitation only "to the extent that the expenses do not exceed the amount of the expenses which" are treated as compensation and wages to the employee or as income to a non-employee. This methodology is also referred to in this preamble as the "dollar-for-dollar" methodology.

The Treasury Department and the IRS are aware that some taxpayers may attempt to claim a full deduction under section 274(e)(2) or (e)(9) by including a value that is less than the amount required to be included under § 1.61-21, which provides the rules for valuation of fringe benefits, or by purportedly including a value of zero, as compensation and wages to the employee, or as includible in gross income by a person who is not an employee of the taxpayer. As a result, the proposed regulations provide that expenses for food or beverages for which the taxpayer calculates a value that is less than the amount required to be included in gross income under § 1.61-21, or for which the amount required to be included in gross income is zero, will not be considered as having been treated as compensation and as wages to the employee, or as includible in gross income by a recipient of the food or beverages who is not an employee of the

taxpayer, for purposes of section 274(e)(2) and (e)(9).

Commenters argued that the proposed rule disallowing the application of section 274(e)(2) and (e)(9) to expenses for which an improper amount is included in compensation and wages or in gross income, as applicable, is unduly harsh given the difficulty in determining the value of food or beverages under §1.61-21 and the possibility of good faith errors. In addition, a commenter noted that neither the “to the extent that” language in section 274(e)(2)(A) nor the holding in *Sutherland Lumber-Southwest* support applying an “all or nothing” rule against the taxpayer.

The Treasury Department and the IRS agree that the “all or nothing” rule included in the proposed regulations may lead to unduly harsh results. Therefore, in response to these comments, the Treasury Department and the IRS revised the rules in proposed §1.274-12(c)(2)(i) to allow a taxpayer to apply section 274(e)(2) and (e)(9), as applicable, in cases where the taxpayer includes an improper amount in compensation and wages, or gross income, of the recipient. However, if a taxpayer includes less than the proper amount in compensation and wages or gross income, the final regulations provide that the taxpayer must apply the dollar-for-dollar methodology that applies in the case of a specified individual. Under that dollar-for-dollar methodology, the taxpayer may deduct meal expenses to the extent that the expenses do not exceed the amount of the expenses that are treated as compensation and wages, or gross income, as applicable.

The Treasury Department and the IRS believe the rules provided in the final regulations avoid the unduly harsh result that could arise by prohibiting application of section 274(e)(2) or (e)(9) in cases where the taxpayer includes some, but not all, of the value of a food or beverage expense in the recipient’s income. In addition, the rules maintain consistency with the IRS’s acquiescence in *Sutherland Lumber*, which provides that the IRS will no longer litigate application of section 274(e)(2) in cases in which a taxpayer demonstrates that it has “properly” included in compensation and wages the value of an employee vacation flight in accordance with §1.61-21(g). See AOD-2002-02. The rules

are also consistent with §1.274-10(a)(2)(ii)(A), which applies the section 274(e)(2) exception to entertainment air travel and provides that a taxpayer must “properly” treat expenses as compensation and wages to an employee and treat the proper amount as compensation under §1.61-21.

For administrability, a commenter suggested that the rule apply to the amounts included on the employee’s Form W-2 or other recipient’s Form 1099-MISC instead of amounts reported as compensation on the service provider’s return. The language in the proposed regulations refers to the treatment of the amount on the “taxpayer’s income tax return as originally filed,” meaning the tax return of the employer, not the employee or service provider. However, to further clarify the rule, §1.274-12(c)(2)(i)(A) of the final regulations no longer references the treatment of the amount on the taxpayer’s income tax return, but instead refers to the treatment of the expense as compensation and wages, consistent with the language in §1.274-10(a)(2)(ii)(A).

A commenter suggested the final regulations address the effect of reimbursements by employees, specified individuals, or other recipients of the food or beverages on the amount excepted from the limitations under section 274(k)(1) and (n)(1) by section 274(e)(2) and (e)(9). The commenter explained that §1.274-10(a)(2)(ii)(C)(2) treats reimbursements in the same manner as compensation and wages for specified individuals, and a similar rule should be provided for reimbursements from non-specified individuals. The commenter pointed out that without a similar rule, expenses for food or beverages provided to specified individuals may be accorded more favorable treatment than expenses provided to non-specified individuals. The Treasury Department and the IRS agree that in cases in which expenditures for food and beverages are reimbursed to the taxpayer, similar treatment should be provided under section 274, regardless of whether the food or beverages are provided to a specified or non-specified individual.

With regard to non-specified individuals, the final regulations provide that a taxpayer may deduct its food or beverage expenses under the exception in section 274(e)(2)(A) or section 274(e)(9) if

the taxpayer includes the proper amount in compensation and wages, or gross income, as applicable. Section 1.61-21(b)(1) provides rules for the valuation of fringe benefits and requires that an employee must include in gross income the amount by which the fair market value of the fringe benefit exceeds the sum of the amount paid for the benefit by or on behalf of the recipient and the amount, if any, specifically excluded from gross income under the Code. Thus, in the case of reimbursements by a recipient, the amount of the reimbursement is taken into account in determining the amount properly includible in the recipient’s income and does not affect the taxpayer’s ability to use the exception in section 274(e)(2)(A) or section 274(e)(9).

With regard to improper inclusions in compensation and wages or gross income, the final regulations provide that the taxpayer must apply the dollar-for-dollar methodology as described in §1.274-12(c)(2)(i)(D). Under that rule, food and beverage expenses are deductible to the extent that the expenses do not exceed the sum of the amount of the expenses that are treated as compensation and wages or gross income, and any amount the recipient reimburses the taxpayer. This dollar-for-dollar rule is the same methodology that applies under section 274(e)(2)(B) for food or beverages provided to specified individuals.

The final regulations also include a provision for specified individuals providing that the exceptions of section 274(e)(2) and (e)(9) generally apply only to the extent that the food or beverage expenses do not exceed the amount of the food or beverage expenses treated as compensation (under section 274(e)(2)) or as income (under section 274(e)(9)) to the specified individual. The final regulations provide, however, that amounts reimbursed to the taxpayer by the specified individual, will reduce the amount subject to the limitations under section 274(k)(1) and (n)(1). This rule conforms to the statutory language in section 274(e)(2)(B) and the regulatory language in §1.274-10. Thus, the final regulations address the comment asking for clarification of the effect of reimbursements by employees, specified individuals, and other recipients of the food or beverages on the amount excepted from

the limitations under section 274(k)(1) and (n)(1) by section 274(e)(2) and (e)(9).

The Treasury Department and the IRS continue to believe that if the amount to be included in compensation and wages or gross income is zero, whether zero is a proper or improper amount, the exceptions in section 274(e)(2) and section 274(e)(9) do not apply because no amount has been included in compensation and wages or gross income. For example, if the amount to be included is zero because the value of the food or beverages is excluded as a fringe benefit under section 132, the exceptions in section 274(e)(2) and (e)(9) do not apply. Similarly, the exceptions in section 274(e)(2) and (e)(9) do not apply if the amount to be included is zero solely because the recipient has fully reimbursed the taxpayer for the food or beverages. In that case, however, the exception in section 274(e)(8) may apply if the food or beverages are sold to the recipient in a bona fide transaction for an adequate and full consideration in money or money's worth.

ii. Food or Beverage Expenses Provided under Reimbursement Arrangements

Pursuant to section 274(e)(3), the final regulations provide that in the case of expenses for food or beverages paid or incurred by one person in connection with the performance of services for another person (whether or not the other person is an employer) under a reimbursement or other expense allowance arrangement, the limitations on deductions in section 274(k)(1) and (n)(1) apply either to the person who makes the expenditure or to the person who actually bears the expense, but not to both. Section 274(e)(3)(B) provides that if the services are performed for a person other than an employer, such as by an independent contractor, the exception in section 274(e)(3) applies only if the taxpayer, in this case, the independent contractor, accounts, to the extent provided by section 274(d), to such person. The final regulations therefore provide that the deduction limitations in section 274(k)(1) and (n)(1) apply to an independent contractor unless, under a reimbursement or other expense allowance arrangement, the contractor accounts to its client or customer with substantiation that satisfies the requirements of section 274(d).

iii. Recreational Expenses for Employees

Pursuant to section 274(e)(4), the final regulations provide that any food or beverage expense paid or incurred by a taxpayer for a recreational, social, or similar activity, primarily for the benefit of the taxpayer's employees, is not subject to the deduction limitations in section 274(k)(1) and (n)(1). However, activities that discriminate in favor of highly compensated employees, officers, shareholders or others who own a 10-percent or greater interest in the business are not considered paid or incurred primarily for the benefit of employees.

Many of the comments received after enactment of the TCJA requested confirmation that food or beverage expenses for company holiday parties and picnics that do not discriminate in favor of highly compensated employees are not subject to the deduction limitations in section 274(k)(1) and (n)(1) because the exception in section 274(e)(4) applies. These comments also suggested that expenses for snacks and beverages available to all employees in a pantry, break room, or copy room are not subject to the deduction limitations in section 274(k)(1) and (n)(1) because the exception in section 274(e)(4) applies.

In response to the questions and comments received, the proposed regulations confirm the rules in the existing regulations at §1.274-2(f)(2)(v) that the exception in section 274(e)(4) applies to food or beverage expenses for company holiday parties, annual picnics, or summer outings that do not discriminate in favor of highly compensated employees. However, an example in the proposed regulations demonstrates that the section 274(e)(4) exception does not apply to free food or beverages available to all employees in a pantry, break room, or copy room because the mere provision or availability of food or beverages is not a recreational, social, or similar activity, despite the fact that employees may incidentally socialize while they are in the break room. The final regulations adopt the proposed regulations with respect to the application of section 274(e)(4) in this context.

In addition, the final regulations provide that the exception in section 274(e)(4) does not apply to food or beverage expenses that are excludable from employ-

ees' income under section 119 as meals provided for the convenience of the employer. Because these food or beverages are, by definition, furnished for the employer's convenience, they cannot also be primarily for the benefit of the employees, even if some social activity occurs during the provision of the food or beverages.

iv. Items Available to the Public

Pursuant to section 274(e)(7), the final regulations provide that food or beverage expenses of a taxpayer are not subject to the deduction limitations in section 274(k)(1) and (n)(1) to the extent the food or beverages are made available to the general public. In addition, the final regulations provide that this exception applies to expenses for food or beverages provided to employees if similar food or beverages are provided by the employer to, and are primarily consumed by, the general public. For this purpose, "primarily consumed" means greater than 50 percent of actual or reasonably estimated consumption, and "general public" includes, but is not limited to, customers, clients, and visitors. The final regulations also provide that the general public does not include employees, partners, 2-percent shareholders of S corporations (as defined in section 1372(b)), or independent contractors of the taxpayer. Further, an exclusive list of guests also is not considered the general public. See *Churchill Downs, Inc. v. Commissioner*, 307 F.3d 423 (6th Cir. 2002).

Comments received in response to Notice 2018-76 requested guidance as to whether the exception in section 274(e)(7) for food or beverages made available by the taxpayer to the general public applies in various situations. The Treasury Department and the IRS considered these comments and included examples in the proposed regulations to illustrate that the exception in section 274(e)(7) generally applies to the entire food or beverage expense if the food or beverages are primarily consumed by the general public. The final regulations retain these examples.

v. Goods or Services Sold to Customers

Pursuant to section 274(e)(8), the final regulations provide that any expense for

food or beverages that are sold to customers in a bona fide transaction for an adequate and full consideration in money or money's worth is not subject to the deduction limitations in section 274(k)(1) and (n)(1). The final regulations clarify that money or money's worth does not include payment through services provided.

The Treasury Department and the IRS are aware of concerns raised by commenters that it is a common business practice for employers of restaurant and food service workers to provide food or beverages at no cost or at a discount to their employees. The Joint Committee on Taxation's Bluebook on the TCJA explains that amendments made by the TCJA to limit the deduction for expenses of the employer associated with providing food or beverages to employees through an employer-operated eating facility that meets the requirements of section 132(e)(2) do not affect other exceptions to the 50-percent limitation on deductions for food or beverage expenses. For example, a restaurant or catering business may continue to deduct 100 percent of its costs for food or beverage items, purchased in connection with preparing and providing meals to its paying customers, which are also consumed at the worksite by employees who work in the employer's restaurant or catering business. Joint Committee on Taxation, *General Explanation of Public Law 115-97* (JCS-1-18), at 186 n.940 and at 188 n.956, December 2018. The final regulations adopt this interpretation of the exception in section 274(e)(8).

Finally, the final regulations provide that for purposes of the section 274(e)(8) exception to the deduction limitations in section 274(k)(1) and (n)(1), the term "customer" includes anyone who is sold food or beverages in a bona fide transaction for an adequate and full consideration in money or money's worth. For example, employees of the taxpayer are customers when they purchase food or beverages from the taxpayer in a bona fide transaction for arm's length, fair market value prices.

Statement of Availability of IRS Documents

Notices 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 Publishing Office, Washington, DC 20402, or by visiting the IRS web site at <http://www.irs.gov>.

Applicability Date

These regulations apply to taxable years that begin on or after October 9, 2020.

Special Analyses

These final 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.

Pursuant to the Regulatory Flexibility Act (5 U.S.C. chapter 6), it is hereby certified that this final rule will not have a significant economic impact on a substantial number of small entities. Although the rule may affect a substantial number of small entities, the economic impact of the regulations is not likely to be significant. Data are not readily available about the number of taxpayers affected, but the number is likely to be substantial for both large and small entities because the rule may affect entities that incur meal and entertainment expenses. The economic impact of these regulations is not likely to be significant, however, because these final regulations substantially incorporate prior guidance and otherwise clarify the application of the TCJA changes to section 274 related to meals and entertainment. These final regulations will assist taxpayers in understanding the changes to section 274 and make it easier for taxpayers to comply with those changes. Accordingly, the Secretary of the Treasury's delegate certifies that the rule will not have a significant economic impact on a substantial number of small entities. Notwithstanding this certification, the Treasury Department and the IRS welcome comments on the impact of these regulations on small entities.

Pursuant to section 7805(f), these final regulations have been submitted to the Chief Counsel for the Office of Advocacy of the Small Business Administration for comment on their impact on small business. No comments on the proposed regulations were received from the Chief Counsel for the Office of Advocacy of the Small Business Administration.

Effect on Other Documents

The following publications are obsolete as of October 9, 2020.

Notice 2018-76 (2018-42 I.R.B. 599).

Drafting Information

The principal author of these final regulations is Patrick Clinton, Office of the Associate Chief Counsel (Income Tax & Accounting). Other personnel from the Treasury Department and the IRS participated in their development.

List of Subjects in 26 CFR Part 1

Income Taxes, Reporting and record-keeping requirements

Adoption of Amendments to the Regulations

Accordingly, 26 CFR Part 1 is amended as follows:

Part 1—INCOME TAX

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

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

Section 1.274-11 also issued under 26 U.S.C. 274.

Section 1.274-12 also issued under 26 U.S.C. 274.

Par. 2. Section 1.274-11 is added to read as follows:

§1.274-11 Disallowance of deductions for certain entertainment, amusement, or recreation expenditures paid or incurred after December 31, 2017.

(a) *In general.* Except as provided in this section, no deduction otherwise allowable under chapter 1 of the Internal Revenue Code (Code) is allowed for any expenditure with respect to an activity that is of a type generally considered to be entertainment, or with respect to a facility used in connection with an entertainment activity. For this purpose, dues or fees to any social, athletic, or sporting club or organization are treated as items with respect to facilities and, thus, are not deductible. In addition, no deduction otherwise

allowable under chapter 1 of the Code is allowed for amounts paid or incurred for membership in any club organized for business, pleasure, recreation, or other social purpose.

(b) *Definitions*—(1) *Entertainment*—(i) *In general.* For section 274 purposes, the term *entertainment* means any activity which is of a type generally considered to constitute entertainment, amusement, or recreation, such as entertaining at bars, theaters, country clubs, golf and athletic clubs, sporting events, and on hunting, fishing, vacation and similar trips, including such activity relating solely to the taxpayer or the taxpayer's family. These activities are treated as entertainment under this section, subject to the objective test, regardless of whether the expenditure for the activity is related to or associated with the active conduct of the taxpayer's trade or business. The term *entertainment* may include an activity, the cost of which otherwise is a business expense of the taxpayer, which satisfies the personal, living, or family needs of any individual, such as providing a hotel suite or an automobile to a business customer or the customer's family. The term *entertainment* does not include activities which, although satisfying personal, living, or family needs of an individual, are clearly not regarded as constituting entertainment, such as the providing of a hotel room maintained by an employer for lodging of employees while in business travel status or an automobile used in the active conduct of a trade or business even though used for routine personal purposes such as commuting to and from work. On the other hand, the providing of a hotel room or an automobile by an employer to an employee who is on vacation would constitute entertainment of the employee.

(ii) *Food or beverages.* Under this section, the term *entertainment* does not include food or beverages unless the food or beverages are provided at or during an entertainment activity. Food or beverages provided at or during an entertainment activity generally are treated as part of the entertainment activity. However, in the case of food or beverages provided at or during an entertainment activity, the food or beverages are not considered entertainment if the food or beverages are purchased separately from the enter-

tainment, or the cost of the food or beverages is stated separately from the cost of the entertainment on one or more bills, invoices, or receipts. The amount charged for food or beverages on a bill, invoice, or receipt must reflect the venue's usual selling cost for those items if they were to be purchased separately from the entertainment or must approximate the reasonable value of those items. If the food or beverages are not purchased separately from the entertainment, or the cost of the food or beverages is not stated separately from the cost of the entertainment on one or more bills, invoices, or receipts, no allocation between entertainment and food or beverage expenses may be made and, except as further provided in this section and section 274(e), the entire amount is a nondeductible entertainment expenditure under this section and section 274(a).

(iii) *Objective test.* An objective test is used to determine whether an activity is of a type generally considered to be entertainment. Thus, if an activity is generally considered to be entertainment, it will be treated as entertainment for purposes of this section and section 274(a) regardless of whether the expenditure can also be described otherwise, and even though the expenditure relates to the taxpayer alone. This objective test precludes arguments that *entertainment* means only entertainment of others or that an expenditure for entertainment should be characterized as an expenditure for advertising or public relations. However, in applying this test the taxpayer's trade or business is considered. Thus, although attending a theatrical performance generally would be considered entertainment, it would not be so considered in the case of a professional theater critic attending in a professional capacity. Similarly, if a manufacturer of dresses conducts a fashion show to introduce its products to a group of store buyers, the show generally would not be considered entertainment. However, if an appliance distributor conducts a fashion show, the fashion show generally would be considered to be entertainment.

(2) *Expenditure.* The term *expenditure* as used in this section includes amounts paid or incurred for goods, services, facilities, and other items, including items such as losses and depreciation.

(3) *Expenditures for production of income.* For purposes of this section, any reference to *trade or business* includes an activity described in section 212.

(c) *Exceptions.* Paragraph (a) of this section does not apply to any expenditure described in section 274(e)(1), (2), (3), (4), (5), (6), (7), (8), or (9).

(d) *Examples.* The following examples illustrate the application of paragraphs (a) and (b) of this section. In each example, assume that the taxpayer is engaged in a trade or business for purposes of section 162 and that neither the taxpayer nor any business associate is engaged in a trade or business that relates to the entertainment activity. Also assume that none of the exceptions under section 274(e) and paragraph (c) of this section apply.

(1) *Example 1.* Taxpayer A invites, B, a business associate, to a baseball game to discuss a proposed business deal. A purchases tickets for A and B to attend the game. The baseball game is entertainment as defined in §1.274-11(b)(1) and thus, the cost of the game tickets is an entertainment expenditure and is not deductible by A.

(2) *Example 2.* The facts are the same as in paragraph (d)(1) of this section (*Example 1*), except that A also buys hot dogs and drinks for A and B from a concession stand. The cost of the hot dogs and drinks, which are purchased separately from the game tickets, is not an entertainment expenditure and is not subject to the disallowance under §1.274-11(a) and section 274(a)(1). Therefore, A may deduct 50 percent of the expenses associated with the hot dogs and drinks purchased at the game if the expenses meet the requirements of section 162 and §1.274-12.

(3) *Example 3.* Taxpayer C invites D, a business associate, to a basketball game. C purchases tickets for C and D to attend the game in a suite, where they have access to food and beverages. The cost of the basketball game tickets, as stated on the invoice, includes the food or beverages. The basketball game is entertainment as defined in §1.274-11(b)(1), and, thus, the cost of the game tickets is an entertainment expenditure and is not deductible by C. The cost of the food and beverages, which are not purchased separately from the game tickets, is not stated separately on the invoice. Thus, the cost of the food and beverages is an entertainment expenditure that is subject to disallowance under section 274(a)(1) and paragraph (a) of this section, and C may not deduct the cost of the tickets or the food and beverages associated with the basketball game.

(4) *Example 4.* The facts are the same as in paragraph (d)(3) of this section (*Example 3*), except that the invoice for the basketball game tickets separately states the cost of the food and beverages and reflects the venue's usual selling price if purchased separately. As in paragraph (d)(3) of this section (*Example 3*), the basketball game is entertainment as defined in §1.274-11(b)(1), and, thus, the cost of the game tickets, other than the cost of the food and beverages, is an entertainment expenditure and is not deductible by C. However, the cost of the food and

beverages, which is stated separately on the invoice for the game tickets and reflects the venue's usual selling price of the food and beverages if purchased separately, is not an entertainment expenditure and is not subject to the disallowance under section 274(a)(1) and paragraph (a) of this section. Therefore, C may deduct 50 percent of the expenses associated with the food and beverages provided at the game if the expenses meet the requirements of section 162 and §1.274-12.

(e) *Applicability date.* This section applies for taxable years that begin on or after October 9, 2020.

Par. 3. Section 1.274-12 is added to read as follows:

§1.274-12 Limitation on deductions for certain food or beverage expenses paid or incurred after December 31, 2017.

(a) *Food or beverage expenses—(1) In general.* Except as provided in this section, no deduction is allowed for the expense of any food or beverages provided by the taxpayer (or an employee of the taxpayer) unless—

(i) The expense is not lavish or extravagant under the circumstances;

(ii) The taxpayer, or an employee of the taxpayer, is present at the furnishing of such food or beverages; and

(iii) The food or beverages are provided to the taxpayer or a business associate.

(2) *Only 50 percent of food or beverage expenses allowed as deduction.* Except as provided in this section, the amount allowable as a deduction for any food or beverage expense described in paragraph (a)(1) of this section may not exceed 50 percent of the amount of the expense that otherwise would be allowable.

(3) *Examples.* The following examples illustrate the application of paragraph (a)(1) and (2) of this section. In each example, assume that the food or beverage expenses are ordinary and necessary expenses under section 162(a) that are paid or incurred during the taxable year in carrying on a trade or business and are not lavish or extravagant under the circumstances. Also assume that none of the exceptions in paragraph (c) of this section apply.

(i) *Example 1.* Taxpayer A takes client B out to lunch. Under section 274(k) and (n) and paragraph (a) of this section, A may deduct 50 percent of the food or beverage expenses.

(ii) *Example 2.* Taxpayer C takes employee D out to lunch. Under section 274(k) and (n) and paragraph (a) of this section, C may deduct 50 percent of the food or beverage expenses.

(iii) *Example 3.* Taxpayer E holds a business meeting at a hotel during which food and beverages are provided to attendees. Expenses for the business meeting, other than the cost of food and beverages, are not subject to the deduction limitations in section 274 and are deductible if they meet the requirements for deduction under section 162. Under section 274(k) and (n) and paragraph (a) of this section, E may deduct 50 percent of the food and beverage expenses.

(iv) *Example 4.* The facts are the same as in paragraph (a)(3)(iii) of this section (*Example 3*), except that all the attendees of the meeting are employees of E. Expenses for the business meeting, other than the cost of food and beverages, are not subject to the deduction limitations in section 274 and are deductible if they meet the requirements for deduction under section 162. Under section 274(k) and (n) and paragraph (a) of this section, E may deduct 50 percent of the food and beverage expenses. The exception in section 274(e)(5) does not apply to food and beverage expenses under section 274(k) and (n).

(4) *Special rules for travel meals.* (i) *In general.* Food or beverage expenses paid or incurred while traveling away from home in pursuit of a trade or business generally are subject to the deduction limitations in section 274(k) and (n) and paragraph (a)(1) and (2) of this section, as well as the substantiation requirements in section 274(d). In addition, travel expenses generally are subject to the limitations in section 274(m)(1), (2), and (3).

(ii) *Substantiation.* Except as provided in this section, no deduction is allowed for the expense of any food or beverages paid or incurred while traveling away from home in pursuit of a trade or business unless the taxpayer meets the substantiation requirements in section 274(d).

(iii) *Travel meal expenses of spouse, dependent or others.* No deduction is allowed under chapter 1 of the Internal Revenue Code (Code), except under section 217 for certain members of the Armed Forces of the United States, for the expense of any food or beverages paid or incurred with respect to a spouse, dependent, or other individual accompanying the taxpayer, or an officer or employee of the taxpayer, on business travel, unless—

(A) The spouse, dependent, or other individual is an employee of the taxpayer;

(B) The travel of the spouse, dependent, or other individual is for a bona fide business purpose of the taxpayer; and

(C) The expenses would otherwise be deductible by the spouse, dependent or other individual.

(D) *Example.* The following example illustrates the application of paragraph (a)(4)(iii) of this section:

(1) *Example.* Taxpayer F, a sole proprietor, and Taxpayer F's spouse travel from New York to Boston to attend a series of business meetings related to F's trade or business. F's spouse is not an employee of F, does not travel to Boston for a bona fide business purpose of F, and the expenses would not otherwise be deductible. While in Boston, F and F's spouse go out to dinner. Under section 274(m)(3) and paragraph (a)(4)(iii) of this section, the expenses associated with the food and beverages consumed by F's spouse are not deductible. Therefore, the cost of F's spouse's dinner is not deductible. F may deduct 50 percent of the expense associated with the food and beverages F consumed while on business travel if F meets the requirements in sections 162 and 274, including section 274(k) and (d).

(2) [Reserved]

(b) *Definitions.* Except as otherwise provided in this section, the following definitions apply for purposes of section 274(k) and (n), §1.274-11(b)(1)(ii) and (d), and this section:

(1) *Food or beverages.* Food or beverages means all food and beverage items, regardless of whether characterized as meals, snacks, or other types of food and beverages, and regardless of whether the food and beverages are treated as *de minimis* fringes under section 132(e).

(2) *Food or beverage expenses.* Food or beverage expenses mean the full cost of food or beverages, including any delivery fees, tips, and sales tax. In the case of employer-provided meals furnished at an eating facility on the employer's business premises, food or beverage expenses do not include expenses for the operation of the eating facility such as salaries of employees preparing and serving meals and other overhead costs.

(3) *Business associate.* Business associate means a person with whom the taxpayer could reasonably expect to engage or deal in the active conduct of the taxpayer's trade or business such as the taxpayer's customer, client, supplier, employee, agent, partner, or professional adviser, whether established or prospective.

(4) *Independent contractor.* For purposes of the reimbursement or other expense allowance arrangements described in paragraph (c)(2)(ii) of this section, independent contractor means a person who is not an employee of the payor.

(5) *Client or customer.* For purposes of the reimbursement or other expense allowance arrangements described in

paragraph (c)(2)(ii) of this section, *client* or *customer* of an independent contractor means a person who receives services from an independent contractor and enters into a reimbursement or other expense allowance arrangement with the independent contractor.

(6) *Payor*. For purposes of the reimbursement or other expense allowance arrangements described in paragraph (c)(2)(ii) of this section, *payor* means a person that enters into a reimbursement or other expense allowance arrangement with an employee and may include an employer, its agent, or a third party.

(7) *Reimbursement or other expense allowance arrangement*. For purposes of the reimbursement or other expense allowance arrangements described in paragraph (c)(2)(ii) of this section, *reimbursement or other expense allowance arrangement* means—

(i) For purposes of paragraph (c)(2)(ii)(B) of this section, an arrangement under which an employee receives an advance, allowance, or reimbursement from a payor for expenses the employee pays or incurs; and

(ii) For purposes of paragraph (c)(2)(ii)(C) of this section, an arrangement under which an independent contractor receives an advance, allowance, or reimbursement from a client or customer for expenses the independent contractor pays or incurs if either—

(A) A written agreement between the parties expressly states that the client or customer will reimburse the independent contractor for expenses that are subject to the limitations on deductions described in paragraph (a) of this section; or

(B) A written agreement between the parties expressly identifies the party subject to the limitations.

(8) *Primarily consumed*. For purposes of paragraph (c)(2)(iv) of this section, *primarily consumed* means greater than 50 percent of actual or reasonably estimated consumption.

(9) *General public*. For purposes of paragraph (c)(2)(iv) of this section, the *general public* includes, but is not limited to, customers, clients, and visitors. The *general public* does not include employees, partners, 2-percent shareholders of S corporations (as defined in section 1372(b)), or independent contractors of

the taxpayer. Also, the guests on an exclusive list of guests are not the *general public*.

(c) *Exceptions*—(1) *In general*. The limitations on the deduction of food or beverage expenses in paragraph (a) of this section do not apply to any expense described in paragraph (c)(2) of this section. These expenses are deductible to the extent allowable under chapter 1 of the Code (chapter 1).

(2) *Exceptions*—(i) *Expenses treated as compensation*—(A) *Expenses includible in income of persons who are employees and are not specified individuals*. In accordance with section 274(e)(2)(A), and except as provided in paragraph (c)(2)(i)(D) of this section, an expense paid or incurred by a taxpayer for food or beverages, if an employee who is not a specified individual is the recipient of the food or beverages, is not subject to the deduction limitations in paragraph (a) of this section to the extent that the taxpayer—

(1) Properly treats the expense relating to the recipient of food or beverages as compensation to an employee under chapter 1 and as wages to the employee for purposes of chapter 24 of the Code (chapter 24); and

(2) Treats the proper amount as compensation to the employee under §1.61-21.

(B) *Expenses includible in income of persons who are not employees and are not specified individuals*. In accordance with section 274(e)(9), and except as provided in paragraph (c)(2)(i)(D) of this section, an expense paid or incurred by a taxpayer for food or beverages is not subject to the deduction limitations in paragraph (a) of this section to the extent that the expenses are properly included in income as compensation for services rendered by, or as a prize or award under section 74 to, a recipient of the expense who is not an employee of the taxpayer and is not a specified individual. The preceding sentence does not apply to any amount paid or incurred by the taxpayer if the amount is required to be included, or would be so required except that the amount is less than \$600, in any information return filed by such taxpayer under part III of subchapter A of chapter 61 of the Code and is not so included.

(C) *Specified Individuals*. In accordance with section 274(e)(2)(B), in the

case of a specified individual (as defined in section 274(e)(2)(B)(ii)), the deduction limitations in paragraph (a) of this section do not apply to an expense for food or beverages of the specified individual to the extent that the amount of the expense does not exceed the sum of—

(1) The amount treated as compensation to the specified individual under chapter 1 and as wages to the specified individual for purposes of chapter 24 (if the specified individual is an employee) or as compensation for services rendered by, or as a prize or award under section 74 to, a recipient of the expense (if the specified individual is not an employee); and

(2) Any amount the specified individual reimburses the taxpayer.

(D) *Expenses for which an amount is excluded from income or is less than the proper amount*. Notwithstanding paragraphs (c)(2)(i)(A) and (B) of this section, in the case of an expense paid or incurred by a taxpayer for food or beverages for which an amount is wholly or partially excluded from a recipient's income under any section of subtitle A of the Code (other than because the amount is reimbursed by the recipient), or for which an amount included in compensation and wages to an employee (or as income to a nonemployee) is less than the amount required to be included under §1.61-21, the deduction limitations in paragraph (a) of this section do not apply to the extent that the amount of the expense does not exceed the sum of—

(1) The amount treated as compensation to the employee under chapter 1 (or as income to a nonemployee) and as wages to the employee for purposes of chapter 24; and

(2) Any amount the recipient reimburses the taxpayer.

(E) *Examples*. The following examples illustrate the application of paragraph (c)(2)(i) of this section. In each example, assume that the food or beverage expenses are ordinary and necessary expenses under section 162(a) that are paid or incurred during the taxable year in carrying on a trade or business.

(1) *Example 1*. Employer G provides food and beverages to its non-specified individual employees without charge at a company cafeteria on its premises. The food and beverages do not meet the definition of a *de minimis* fringe under section 132(e). Thus, G treats the full fair market value of the food and beverages

age expenses as compensation and wages, and properly determines this amount under §1.61-21. Under section 274(e)(2) and paragraph (c)(2)(i)(A) of this section, the expenses associated with the food and beverages provided to the employees are not subject to the 50 percent deduction limitation in paragraph (a) of this section. Thus, G may deduct 100 percent of the food and beverage expenses.

(2) *Example 2.* The facts are the same as in (c)(2)(i)(E)(I) of this section (*Example 1*), except that each employee pays \$8 per day for the food and beverages. The fair market value of the food and beverages is \$10 per day, per employee. G incurs \$9 per day, per employee for the food and beverages. G treats the food and beverage expenses as compensation and wages, and properly determines the amount of the inclusion under §1.61-21 to be \$2 per day, per employee (\$10 fair market value - \$8 reimbursed by the employee = \$2). Therefore, under paragraph (c)(2)(i)(A) of this section, G may deduct 100 percent of the food and beverage expenses, or \$9 per day, per employee.

(3) *Example 3.* Employer H provides meals to its employees without charge. The meals are properly excluded from the employees' income under section 119 as meals provided for the convenience of the employer. Under §1.61-21(b)(1), an employee must include in gross income the amount by which the fair market value of a fringe benefit exceeds the sum of the amount, if any, paid for the benefit by or on behalf of the recipient, and the amount, if any, specifically excluded from gross income by some other section of subtitle A of the Code. Because the entire value of the employees' meals is excluded from the employees' income under section 119, the fair market value of the fringe benefit does not exceed the amount excluded from gross income under subtitle A of the Code, so there is nothing to be included in the employees' income under §1.61-21. Thus, the exception in section 274(e)(2) and paragraph (c)(2)(i) of this section does not apply and, assuming no other exceptions provided under section 274(n)(2) and paragraph (c)(2) of this section apply, H may deduct only 50 percent of the expenses for the food and beverages provided to employees. In addition, the limitations in section 274(k)(1) and paragraph (a)(1) of this section apply because none of the exceptions in section 274(k)(2) and paragraph (c)(2) of this section apply.

(ii) *Reimbursed food or beverage expenses—(A) In general.* In accordance with section 274(e)(3), in the case of expenses for food or beverages paid or incurred by one person in connection with the performance of services for another person, whether or not the other person is an employer, under a reimbursement or other expense allowance arrangement, the deduction limitations in paragraph (a) of this section apply either to the person who makes the expenditure or to the person who actually bears the expense, but not to both. If an expense of a type described in paragraph (c)(2)(ii) of this section properly constitutes a dividend paid to a share-

holder, unreasonable compensation paid to an employee, a personal expense, or other nondeductible expense, nothing in this exception prevents disallowance of the deduction to the taxpayer under other provisions of the Code.

(B) *Reimbursement arrangements involving employees.* In the case of expenses paid or incurred by an employee for food or beverages in performing services as an employee under a reimbursement or other expense allowance arrangement with a payor, the limitations on deductions in paragraph (a) of this section apply—

(I) To the employee to the extent the employer treats the reimbursement or other payment of the expense on the employer's income tax return as originally filed as compensation paid to the employee and as wages to the employee for purposes of withholding under chapter 24 relating to collection of income tax at source on wages; or

(2) To the payor to the extent the reimbursement or other payment of the expense is not treated as compensation and wages paid to the employee in the manner provided in paragraph (c)(2)(ii)(B)(I) of this section. However, see paragraph (c)(2)(ii)(C) of this section if the payor receives a payment from a third party that may be treated as a reimbursement arrangement under that paragraph.

(C) *Reimbursement arrangements involving persons that are not employees.* In the case of expenses for food or beverages paid or incurred by an independent contractor in connection with the performance of services for a client or customer under a reimbursement or other expense allowance arrangement with the independent contractor, the limitations on deductions in paragraph (a) of this section apply to the party expressly identified in an agreement between the parties as subject to the limitations. If an agreement between the parties does not expressly identify the party subject to the limitations, then the deduction limitations in paragraph (a) of this section apply—

(I) To the independent contractor (which may be a payor) to the extent the independent contractor does not account to the client or customer within the meaning of section 274(d); or

(2) To the client or customer if the independent contractor accounts to the

client or customer within the meaning of section 274(d).

(D) *Section 274(d) substantiation.* If the reimbursement or other expense allowance arrangement involves persons who are not employees and the agreement between the parties does not expressly identify the party subject to the limitations on deductions in paragraph (a) of this section, the limitations on deductions in paragraph (a) of this section apply to the independent contractor unless the independent contractor accounts to the client or customer with substantiation that satisfies the requirements of section 274(d).

(E) *Examples.* The following examples illustrate the application of paragraph (c)(2)(ii) of this section.

(I) *Example 1.* (i) Employee I performs services under an arrangement in which J, an employee leasing company, pays I a per diem allowance of \$10x for each day that I performs services for J's client, K, while traveling away from home. The per diem allowance is a reimbursement of travel expenses for food or beverages that I pays in performing services as an employee. J enters into a written agreement with K under which K agrees to reimburse J for any substantiated reimbursements for travel expenses, including meal expenses, that J pays to I. The agreement does not expressly identify the party that is subject to the limitations on deductions in paragraph (a) of this section. I performs services for K while traveling away from home for 10 days and provides J with substantiation that satisfies the requirements of section 274(d) of \$100x of meal expenses incurred by I while traveling away from home. J pays I \$100x to reimburse those expenses pursuant to their arrangement. J delivers a copy of I's substantiation to K. K pays J \$300x, which includes \$200x compensation for services and \$100x as reimbursement of J's payment of I's travel expenses for meals. Neither J nor K treats the \$100x paid to I as compensation or wages.

(ii) Under paragraph (b)(7)(i) of this section, I and J have established a reimbursement or other expense allowance arrangement for purposes of paragraph (c)(2)(ii)(B) of this section. Because the reimbursement payment is not treated as compensation and wages paid to I, under section 274(e)(3)(A) and paragraph (c)(2)(ii)(B)(I) of this section, I is not subject to the limitations on deductions in paragraph (a) of this section. Instead, under paragraph (c)(2)(ii)(B)(2) of this section, J, the payor, is subject to limitations on deductions in paragraph (a) of this section unless J can meet the requirements of section 274(e)(3)(B) and paragraph (c)(2)(ii)(C) of this section.

(iii) Because the agreement between J and K expressly states that K will reimburse J for substantiated reimbursements for travel expenses that J pays to I, under paragraph (b)(7)(ii)(A) of this section, J and K have established a reimbursement or other expense allowance arrangement for purposes of paragraph (c)(2)(ii)(C) of this section. J accounts to K for K's reimbursement in the manner required by section 274(d) by delivering to K a copy of the

substantiation J received from I. Therefore, under section 274(e)(3)(B) and paragraph (c)(2)(ii)(C)(2) of this section, K and not J is subject to the deduction limitations in paragraph (a) of this section.

(2) *Example 2.* (i) The facts are the same as in paragraph (c)(2)(ii)(E)(1) of this section (*Example 1*) except that, under the arrangements between I and J and between J and K, I provides the substantiation of the expenses directly to K, and K pays the per diem directly to I.

(ii) Under paragraph (b)(7)(i) of this section, I and K have established a reimbursement or other expense allowance arrangement for purposes of paragraph (c)(2)(ii)(C) of this section. Because I substantiates directly to K and the reimbursement payment was not treated as compensation and wages paid to I, under section 274(e)(3)(A) and paragraph (c)(2)(ii)(C)(1) of this section, I is not subject to the limitations on deductions in paragraph (a) of this section. Under paragraph (c)(2)(ii)(C)(2) of this section, K, the payor, is subject to the limitations on deductions in paragraph (a) of this section.

(3) *Example 3.* (i) The facts are the same as in paragraph (c)(2)(ii)(E)(1) of this section (*Example 1*), except that the written agreement between J and K expressly provides that the limitations of this section will apply to K.

(ii) Under paragraph (b)(7)(ii)(B) of this section, J and K have established a reimbursement or other expense allowance arrangement for purposes of paragraph (c)(2)(ii)(C) of this section. Because the agreement provides that the 274 deduction limitations apply to K, under section 274(e)(3)(B) and paragraph (c)(2)(ii)(C) of this section, K and not J is subject to the limitations on deductions in paragraph (a) of this section.

(4) *Example 4.* (i) The facts are the same as in (c)(2)(ii)(E)(1) of this section (*Example 1*), except that the agreement between J and K does not provide that K will reimburse J for travel expenses.

(ii) The arrangement between J and K is not a reimbursement or other expense allowance arrangement within the meaning of section 274(e)(3)(B) and paragraph (b)(7)(ii) of this section. Therefore, even though J accounts to K for the expenses, J is subject to the limitations on deductions in paragraph (a) of this section.

(iii) *Recreational expenses for employees—(A) In general.* In accordance with section 274(e)(4), any food or beverage expense paid or incurred by a taxpayer for a recreational, social, or similar activity, primarily for the benefit of a taxpayer's employees (other than employees who are highly compensated employees (within the meaning of section 414(q))) is not subject to the deduction limitations in paragraph (a) of this section. For purposes of this paragraph (c)(2)(iii), an employee owning less than a 10-percent interest in the taxpayer's trade or business is not considered a shareholder or other owner, and for such purposes an employee is treated as owning any interest owned by a member of the employee's family (within the

meaning of section 267(c)(4)). Any expense for food or beverages that is made under circumstances which discriminate in favor of highly compensated employees is not considered to be made primarily for the benefit of employees generally. An expense for food or beverages is not to be considered outside of the exception of this paragraph (c)(2)(iii) merely because, due to the large number of employees involved, the provision of food or beverages is intended to benefit only a limited number of employees at one time, provided the provision of food or beverages does not discriminate in favor of highly compensated employees. This exception applies to expenses paid or incurred for events such as holiday parties, annual picnics, or summer outings. This exception does not apply to expenses for meals the value of which is excluded from employees' income under section 119 because the meals are provided for the convenience of the employer and are therefore not primarily for the benefit of the taxpayer's employees.

(B) *Examples.* The following examples illustrate the application of this paragraph (c)(2)(iii). In each example, assume that the food or beverage expenses are ordinary and necessary expenses under section 162(a) that are paid or incurred during the taxable year in carrying on a trade or business.

(1) *Example 1.* Employer L invites all employees to a holiday party in a hotel ballroom that includes a buffet dinner and an open bar. Under section 274(e)(4), this paragraph (c)(2)(iii), and §1.274-11(c), the cost of the party, including food and beverage expenses, is not subject to the deduction limitations in paragraph (a) of this section because the holiday party is a recreational, social, or similar activity primarily for the benefit of non-highly compensated employees. Thus, L may deduct 100 percent of the cost of the party.

(2) *Example 2.* The facts are the same as in paragraph (c)(2)(iii)(B)(1) of this section (*Example 1*), except that Employer L invites only highly-compensated employees to the holiday party, and the invoice provided by the hotel lists the costs for food and beverages separately from the cost of the rental of the ballroom. The costs reflect the venue's usual selling price for food or beverages. The exception in this paragraph (c)(2)(iii) does not apply to the rental of the ballroom or the food and beverage expenses because L invited only highly-compensated employees to the holiday party. However, under §1.274-11(b)(1)(ii), the food and beverage expenses are not treated as entertainment. Therefore, L is not subject to the full disallowance for its separately stated food and beverage expense under section 274(a)(1) and §1.274-11(a). Unless another exception in section

274(n)(2) and paragraph (c)(2) of this section applies, L may deduct only 50 percent of the food and beverage costs under paragraph (a)(2) of this section. In addition, the limitations in section 274(k)(1) and paragraph (a)(1) of this section apply because none of the exceptions in section 274(k)(2) and paragraph (c)(2) of this section apply.

(3) *Example 3.* Employer M provides free coffee, soda, bottled water, chips, donuts, and other snacks in a break room available to all employees. A break room is not a recreational, social, or similar activity primarily for the benefit of the employees, even if some socializing related to the food and beverages provided occurs. Thus, the exception in section 274(e)(4) and this paragraph (c)(2)(iii) does not apply and unless another exception in section 274(n)(2) and paragraph (c)(2) of this section applies, M may deduct only 50 percent of the expenses for food and beverages provided in the break room under paragraph (a)(2) of this section. In addition, the limitations in section 274(k)(1) and paragraph (a)(1) of this section apply because none of the exceptions in section 274(k)(2) and paragraph (c)(2) of this section apply.

(4) *Example 4.* Employer N has a written policy that employees in a certain medical services-related position must be available for emergency calls due to the nature of the position that requires frequent emergency responses. Because these emergencies can and do occur during meal periods, N furnishes food and beverages to employees in this position without charge in a cafeteria on N's premises. N excludes food and beverage expenses from the employees' income as meals provided for the convenience of the employer excludable under section 119. Because these food and beverages are furnished for the employer's convenience, and therefore are not primarily for the benefit of the employees, the exception in section 274(e)(4) and this paragraph (c)(2)(iii) does not apply, even if some socializing related to the food and beverages provided occurs. Further, the exception in section 274(e)(2) and paragraph (c)(2)(i) of this section does not apply. Thus, unless another exception in section 274(n)(2) and paragraph (c)(2) of this section applies, N may deduct only 50 percent of the expenses for food and beverages provided to employees in the cafeteria under paragraph (a)(2) of this section. In addition, the limitations in section 274(k)(1) and paragraph (a)(1) of this section apply because none of the exceptions in section 274(k)(2) and paragraph (c)(2) of this section apply.

(5) *Example 5.* Employer O invites an employee and a client to dinner at a restaurant. Because it is the birthday of the employee, O orders a special dessert in celebration. Because the meal is a business meal, and therefore not primarily for the benefit of the employee, the exception in section 274(e)(4) and this paragraph (c)(2)(iii) does not apply, even though an employee social activity in the form of a birthday celebration occurred during the meal. Thus, unless another exception in section 274(n)(2) and paragraph (c)(2) of this section applies, O may deduct only 50 percent of the meal expense. In addition, the limitations in section 274(k)(1) and paragraph (a)(1) of this section apply because none of the exceptions in section 274(k)(2) and paragraph (c)(2) of this section apply.

(iv) *Items available to the public*—(A) *In general.* In accordance with section 274(e)(7), any expense paid or incurred by a taxpayer for food or beverages to the extent the food or beverages are made available to the general public is not subject to the deduction limitations in paragraph (a) of this section. If a taxpayer provides food or beverages to employees, this exception applies to the entire amount of expenses for those food or beverages if the same type of food or beverages is provided to, and are primarily consumed by, the general public.

(B) *Examples.* The following examples illustrate the application of this paragraph (c)(2)(iv). In each example, assume that the food and beverage expenses are ordinary and necessary expenses under section 162(a) that are paid or incurred during the taxable year in carrying on a trade or business.

(1) *Example 1.* Employer P is a real estate agent and provides refreshments at an open house for a home available for sale to the public. The refreshments are consumed by P's employees, potential buyers of the property, and other real estate agents. Under section 274(e)(7) and this paragraph (c)(2)(iv), the expenses associated with the refreshments are not subject to the deduction limitations in paragraph (a) of this section if P determines that over 50 percent of the food and beverages are actually or reasonably estimated to be consumed by potential buyers and other real estate agents. If more than 50 percent of the food and beverages are not actually or reasonably estimated to be consumed by the general public, only the costs attributable to the food and beverages provided to the general public are excepted under section 274(e)(7) and this paragraph (c)(2)(iv). In addition, the limitations in section 274(k)(1) and paragraph (a)(1) of this section apply to the expenses associated with the refreshments that are not excepted under section 274(e)(7) and this paragraph (c)(2)(iv).

(2) *Example 2.* Employer Q is an automobile service center and provides refreshments in its waiting area. The refreshments are consumed by Q's employees and customers, and Q reasonably estimates that more than 50 percent of the refreshments are consumed by customers. Under section 274(e)(7) and this paragraph (c)(2)(iv), the expenses associated with the refreshments are not subject to the deduction limitations provided for in paragraph (a) of this section because the food and beverages are primarily consumed by customers. Thus, Q may deduct 100 percent of the food and beverage expenses.

(3) *Example 3.* Employer R operates a summer camp open to the general public for children and provides breakfast and lunch, as part of the fee to attend camp, both to camp counselors, who are employees, and to camp attendees, who are customers. There are 20 camp counselors and 100 camp attendees. The same type of meal is available to each counselor and attendee, and attendees consume more than 50 per-

cent of the food and beverages. Under section 274(e)(7) and this paragraph (c)(2)(iv), the expenses associated with the food and beverages are not subject to the deduction limitations in paragraph (a) of this section, because over 50 percent of the food and beverages are consumed by camp attendees and the food and beverages are therefore primarily consumed by the general public. Thus, R may deduct 100 percent of the food and beverage expenses.

(4) *Example 4.* Employer S provides food and beverages to its employees without charge at a company cafeteria on its premises. Occasionally, customers or other visitors also eat without charge in the cafeteria. The occasional consumption of food and beverages at the company cafeteria by customers and visitors is less than 50 percent of the total amount of food and beverages consumed at the cafeteria. Therefore, the food and beverages are not primarily consumed by the general public, and only the costs attributable to the food and beverages provided to the general public are excepted under section 274(e)(7) and this paragraph (c)(2)(iv). In addition, the limitations in section 274(k)(1) and paragraph (a)(1) of this section apply to the expenses associated with the food and beverages that are not excepted under section 274(e)(7) and this paragraph (c)(2)(iv).

(v) *Goods or services sold to customers*—(A) *In general.* In accordance with section 274(e)(8), an expense paid or incurred for food or beverages, to the extent the food or beverages are sold to customers in a bona fide transaction for an adequate and full consideration in money or money's worth, is not subject to the deduction limitations in paragraph (a) of this section. However, *money or money's worth* does not include payment through services provided. Under this paragraph (c)(2)(v), a restaurant or catering business may deduct 100 percent of its costs for food or beverage items, purchased in connection with preparing and providing meals to its paying customers, which are also consumed at the worksite by employees who work in the employer's restaurant or catering business. In addition, for purposes of this paragraph (c)(2)(v), the term *customer* includes anyone, including an employee of the taxpayer, who is sold food or beverages in a bona fide transaction for an adequate and full consideration in money or money's worth.

(B) *Example.* The following example illustrates the application of this paragraph (c)(2)(v):

Example. Employer T operates a restaurant. T provides food and beverages to its food service employees before, during, and after their shifts for no consideration. Under section 274(e)(8) and this paragraph (c)(2)(v), the expenses associated with the food and beverages provided to the employees are not subject to the 50 percent deduction limitation in paragraph (a) of this section because the restaurant

sells food and beverages to customers in a bona fide transaction for an adequate and full consideration in money or money's worth. Thus, T may deduct 100 percent of the food and beverage expenses.

(d) *Applicability date.* This section applies for taxable years that begin on or after October 9, 2020.

Sunita Lough,
Deputy Commissioner for Services
and Enforcement.

Approved September 25, 2020.

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

(Filed by the Office of the Federal Register on October 2, 2020, 4:15 p.m., and published in the issue of the Federal Register for October 9, 2020, 85 F.R. 64026)

26 CFR 301.6402-2(g)

T.D. 9940

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 301

Misdirected Direct Deposit Refunds

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: These final regulations provide the procedures under section 6402(n) of the Internal Revenue Code (Code) for identification and recovery of a misdirected direct deposit refund. The final regulations reflect changes to the law made by the Taxpayer First Act. The final regulations affect taxpayers who have made a claim for refund, requested the refund be issued as a direct deposit, but did not receive a refund in the account designated on the claim for refund.

DATES: *Effective date:* These regulations are effective on December 22, 2020.

Applicability date: These regulations apply to reports to the IRS made after December 22, 2020 that a taxpayer never received a direct deposit refund.

FOR FURTHER INFORMATION CONTACT: Mary C. King at (202) 317-5433 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains amendments to 26 CFR part 301 under section 6402(n) of the Code and provides guidance on the procedures used to identify and recover tax refunds issued by electronic funds transfer (direct deposit) that were not delivered to the account designated to receive the direct deposit refund on the federal tax return or other claim for refund. Section 6402(n) was added to the Code by section 1407 of the Taxpayer First Act, Public Law 116-25, 133 Stat. 981 (2019) (TFA) on July 1, 2019. On December 23, 2019, the Department of the Treasury (Treasury Department) and the IRS published in the **Federal Register** (84 FR 70462) a notice of proposed rulemaking (REG-116163-19) providing the procedures under section 6402(n) for reporting, identification, and recovery of a misdirected direct deposit refund. The Treasury Department and the IRS received one comment responding to the proposed regulations. The comment is available at www.regulations.gov or upon request. No public hearing was requested or held on the proposed regulations.

After consideration of the written comment, this Treasury Decision adopts the proposed regulations as final regulations with minor modifications, as described in the Summary of Comments and Explanation of Provisions. A detailed explanation of these regulations can be found in the preamble to the proposed regulations.

Summary of Comments and Explanation of Provisions

The Treasury Department and the IRS received one comment regarding the proposed regulations. After consideration of the comment, the proposed regulations are adopted as final regulations without any substantive changes.

I. Applicability Date

A commenter expressed a concern that the procedures in these regulations would not apply to claims for refund from taxable years before the applicability date of the final regulations. The commenter requested that the procedures should be applied to refund claims for prior years. Consistent with the comment, the final regulations clarify that these procedures apply to any report of a misdirected direct deposit refund for a current or prior year submitted after the publication of the final regulations in the **Federal Register**.

II. Coordination with Financial Institutions

Section 301.6402-2(g)(1) of the proposed regulations defines “misdirected direct deposit refund” as any refund of an overpayment of tax that is disbursed as a direct deposit but is not deposited into the account designated on the claim for refund to receive the direct deposit refund. The proposed regulations include in the definition of a misdirected direct deposit refund only those refunds which are actually issued as a direct deposit. A misdirected direct deposit refund does not include an overpayment that is credited against another outstanding tax liability of the taxpayer pursuant to section 6402(a) or that is offset pursuant to the law. An overpayment that is offset or applied as mandated by law is not a misdirected direct deposit refund because these actions are mandated by law. Section 301.6402-2(g)(1) of the final regulations clarifies this by striking the last sentence from the proposed regulations, as it is not needed to define a “misdirected direct deposit refund.” Instead, the final regulations clarify in section 301.6402-2(g)(3)(i) that the offset or setoff of an overpayment occurs prior to the issuance of a direct deposit. The IRS will determine if a reported missing refund is setoff or offset as part of the procedure for the identification of the account that received the misdirected direct deposit refund. This reorganization simplifies the definition of a misdirected direct deposit refund and more accurately describes the process of identification of a misdirected direct deposit refund.

The final regulations reflect this clarification to the definition of a misdirected direct deposit refund and the identification procedure, but the proposed regulations are otherwise adopted without change.

Special Analyses

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 Treasury Department and the Office of Management and Budget regarding review of tax regulations.

These regulations do not impose any additional information collection requirements in the form of reporting, recordkeeping requirements, or third-party disclosure requirements related to tax compliance. However, because a taxpayer or a taxpayer’s representative may elect to report a missing refund using the procedures described in §301.6402-2(g)(2)(ii)(B), some taxpayers may use a form to report a missing refund. The collection of information in §301.6402-2(g)(2)(ii)(B) is through use of a Form 3911, “Taxpayer Statement Regarding Refund,” and is the sole collection of information requirement established by the final regulations.

For the purposes of the Paperwork Reduction Act, 44 U.S.C. §§3501-3520, the reporting burden associated with the collection of information with respect to section 6402(n) will be reflected in Paperwork Reduction Act submissions for IRS Form 3911 (OMB Control Number 1545-1384). The estimated average time to complete Form 3911 is five minutes. However, use of a form is not required in every case. There are certain situations in which a taxpayer may instead elect to investigate a missing refund over the telephone or in person at the Office of the Taxpayer Advocate and, after the IRS identifies the tax refund and informs the taxpayer that the refund was issued as a direct deposit, orally report that the already-identified refund is missing. 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.

It is hereby certified that these regulations will not have a significant economic

impact on a substantial number of small entities within the meaning of section 601(6) of the Regulatory Flexibility Act (5 U.S.C. chapter 6). The certification is based on the information that follows. There is no significant impact from these regulations on any small entity utilizing the procedures prescribed by these regulations to report a missing refund because there is no significant cost associated with reporting a missing refund. There is no fee charged in connection with reporting a missing refund, and the estimated time to complete a Form 3911, "Taxpayer Statement Regarding Refund," is five minutes. There are no tax consequences associated with the final rule, as it merely sets forth the procedures for reporting a missing refund and describes the process the IRS uses in locating a missing refund and, in some instances, issuing a replacement refund. The process in these regulations mirrors the existing process and does not change the reporting burden. Accordingly, the Treasury Department and the IRS have determined that this Treasury Decision will not have a significant economic impact on a substantial number of small entities. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking preceding this regulation was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business entities, and no comments were received.

Section 202 of the Unfunded Mandates Reform Act of 1995 requires that agencies assess anticipated costs and benefits and take certain other actions before issuing a final rule that includes any Federal mandate that may result in expenditures in any one year by a state, local, or tribal government, in the aggregate, or by the private sector, of \$100 million in 1995 dollars, updated annually for inflation. This regulation does not include any Federal mandate that may result in expenditures by state, local, or tribal governments, or by the private sector in excess of that threshold.

Executive Order 13132 (titled Federalism) prohibits an agency from publishing any rule that has federalism implications if the rule either imposes substantial, direct compliance costs on state and local governments, and is not required by statute, or preempts state law, unless the agen-

cy meets the consultation and funding requirements of section 6 of the Executive Order. This rule does not have federalism implications and does not impose substantial direct compliance costs on state and local governments or preempt state law, within the meaning of the Executive Order.

Drafting Information

The principal author of these regulations is Mary C. King of the Office of the Associate Chief Counsel (Procedure and Administration). Other personnel from the Treasury Department and the IRS participated in the development of the regulations.

List of Subjects in 26 CFR Part 301

Employment taxes, Estate taxes, Excise taxes, Gift taxes, Income taxes, Penalties, Reporting and recordkeeping requirements.

Adoption of 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 is amended by adding an entry in numerical order for § 301.6402-2(g) to read in part as follows:

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

Section 301.6402-2(g) also issued under 26 U.S.C. 6402(n).

* * * * *

Par. 2. Section 301.6402-2 is amended by:

1. Redesignating paragraph (g) as paragraph (h) and adding new paragraph (g).
2. Revising the heading of newly redesignated paragraph (h) and adding a sentence at the end of the paragraph.

The additions and revision read as follows:

§301.6402-2 *Claims for credit or refund.*

* * * * *

(g) *Misdirected direct deposit refund—*
(1) *Definition.* The term *misdirected direct deposit refund* includes any refund of an overpayment of tax that is disbursed as a direct deposit but is not deposited into the account designated on the claim for refund to receive the direct deposit refund.

(2) *Procedures for reporting a misdirected direct deposit refund—*(i) *In general.* A taxpayer or a taxpayer's authorized representative may report to the IRS that the taxpayer never received a direct deposit refund and request a replacement refund. The report must include the name of the taxpayer who requested the refund, the taxpayer identification number of the taxpayer, the taxpayer's mailing address, the type of return to which the refund is related, the account number and routing number that the taxpayer requested the refund be directly deposited into, and any other information necessary to locate the misdirected direct deposit refund.

(ii) *How to report a misdirected direct deposit refund.* A reporting described in paragraph (g)(2)(i) of this section may be made in the following ways:

(A) By calling the IRS;

(B) On the form prescribed by the IRS and in accordance with the applicable publications, instructions, or other appropriate guidance;

(C) By contacting the Office of the Taxpayer Advocate by telephone, by mail, facsimile, or in person; or

(D) By submitting the appropriate form in person at a Taxpayer Assistance Center.

(3) *Procedures for coordination with financial institutions—*(i) *Identification of the account that received the misdirected direct deposit refund.* If the IRS receives a report described in paragraph (g)(2)(ii) of this section, the IRS will confirm that the overpayment was issued as a direct deposit. The IRS will confirm that the overpayment was not credited or offset pursuant to the law in effect immediately prior to the direct deposit being disbursed. If the direct deposit described in the report was issued, the IRS will initiate a refund trace to request the assistance of the Department of the Treasury's Bureau of the Fiscal Service. In accordance with its own procedures, the Bureau of the Fiscal Service coordinates with the financial institution that holds directly or indirectly the deposit account into which the refund was

made, requesting from the financial institution such information as is necessary to identify whether the financial institution received the refund; whether the financial institution returned, or will return, the refund to the IRS, or if no funds are available for return; whether a deposit was made into the account designated on the claim for refund; and the identity of the deposit account owner to whom the deposit was disbursed.

(ii) *Coordination to recover the amounts transferred.* Recovery of the misdirected direct deposit refund from a financial institution shall follow the procedures established by the Bureau of the Fiscal Service. The Bureau of the Fiscal Service shall request the return of the misdirected direct deposit refund from the financial institution that received it. The IRS may contact the financial institution directly to recover the misdirected direct deposit refund.

(4) *Issuance of replacement refund.* When the IRS has determined that a misdirected direct deposit refund has occurred, the IRS will issue a replacement refund in the full amount of the refund that was misdirected. The replacement refund may be issued as a direct deposit or as a paper check sent to the taxpayer's last known address.

(5) *Applicability of this paragraph (g) to missing refunds.* The provisions of paragraphs (g)(2) through (g)(3)(i) of this section should be used for any refund that was disbursed as a direct deposit and that the taxpayer reports as missing. For example, although a refund that was deposited into an incorrect bank account because the taxpayer transposed two digits in their bank account number is not considered to be a misdirected direct deposit refund, the provisions of paragraphs (g)(2) through (g)(3)(i) of this section should be used. If the appli-

cation of these procedures results in an amount recovered by the IRS, the recovered amount will be refunded or credited as allowed by law.

(h) *Applicability dates.* * * * Paragraph (g) of this section applies to reports described in paragraph (g)(2)(ii) of this section made after December 22, 2020.

Sunita Lough,
Deputy Commissioner for Services and
Enforcement.

Approved: December 8, 2020.

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

(Filed by the Office of the Federal Register on December 18, 2020, 4:15 pm, and published in the issue of the Federal Register for December 22, 2020, 85 FR 83446)

Part III

Mandatory E-filing of Form 4720 by Private Foundations

Notice 2021-01

SECTION 1. PURPOSE

This notice provides for the delay, pursuant to section 3101(d)(2) of the Taxpayer First Act of 2019, Pub. L. No. 116-25, 133 Stat. 981, 1015 (TFA), of the application of section 6033(n) of the Internal Revenue Code (Code) with respect to the requirement for organizations recognized as tax exempt under section 501(c)(3) of the Code and classified as private foundations under section 509(a) of the Code (private foundations) to electronically file Form 4720, *Return of Certain Excise Taxes Under Chapters 41 and 42 of the Internal Revenue Code*.¹ This notice also announces that the Department of the Treasury (Treasury Department) and the Internal Revenue Service (IRS) intend to remove § 53.6011-1(c) of the Foundation and Similar Excise Tax Regulations (26 CFR part 53), because the amendments made to sections 6104 and 6033 by the TFA have rendered unfeasible the ability for a private foundation and other persons to jointly file the same Form 4720 electronically.

SECTION 2. BACKGROUND

Section 6011(a) of the Code provides that, when required by regulations prescribed by the Secretary of the Treasury or his delegate (Secretary), any person made liable for any tax imposed by the Code, or with respect to the collection thereof, must make a return or statement according to the forms and regulations prescribed by the Secretary. Every person required to make a return or statement must include therein the information required by such forms or regulations. Under § 53.6011-1(b), every person (including a govern-

mental entity) liable for tax imposed by sections 4941(a), 4942(a), 4943(a), 4944(a), 4945(a), 4955(a), 4958(a), 4959, 4960(a), 4965(a), 4966(a), 4967(a), or 4968(a), and every private foundation and every trust described in section 4947(a)(2) which has engaged in an act of self-dealing (as defined in section 4941(d)) (other than an act giving rise to no tax under section 4941(a)) must file an annual return on Form 4720 and must include therein the information required by such form and the instructions issued with respect thereto. Under § 53.6011-1(c), if a Form 4720 is filed by a private foundation or trust described in section 4947(a)(2) with respect to a transaction as to which other persons are also required to file under this regulation, and if the other persons' taxable years are the same as the foundation's or trust's, then the private foundation or trust and such other persons can file a joint Form 4720, and, to the extent applicable, that form will be considered as the other persons' return for purposes of complying with the filing requirement under § 53.6011-1(b).

Subject to various exceptions, section 6033(a)(1) of the Code requires every organization exempt from taxation under section 501(a) (tax-exempt organization) to file an annual return, stating specifically the items of gross income, receipts, and disbursements, and such other information for the purpose of carrying out the internal revenue laws as the Secretary may by forms or regulations prescribe. Section 6033(b) provides a list of items that are generally required to be furnished annually by organizations described in section 501(c)(3), "at such time and in such manner as the Secretary may by forms or regulations prescribe."

Consistent with section 6033(a)(1), § 1.6033-2(a)(1) of the Income Tax Regulations (26 CFR part 1) provides that, except as provided in section 6033(a)(3) and § 1.6033-2(g), every tax-exempt organization must file an annual information return specifically setting forth its items of gross income, gross receipts and disbursements,

and such other information as may be prescribed in the instructions issued with respect to the return. Section 1.6033-2(a)(2)(i) provides that every private foundation must file Form 990-PF, *Return of Private Foundation*, as its annual information return. Although the information to be reported for any particular taxable year is set forth in the forms and instructions for such year, § 1.6033-2(a)(2)(ii) also provides a list of information generally required to be furnished by a tax-exempt organization on its annual return, which generally tracks section 6033(b). The list in the regulations includes, but is not limited to, in the case of a private foundation liable for tax imposed under chapter 42 of the Code (chapter 42), such information as is required on Form 4720. See § 1.6033-2(a)(2)(ii)(J).

In general, under section 6104(b) of the Code, the information required to be furnished by section 6033, together with the names and addresses of such organizations and trusts, must be made available to the public at such times and in such places as the Secretary may prescribe. Section 301.6104(b)-1(a)(1) of the Procedure and Administration Regulations reiterates that the information required by section 6033 must be made available to the public, except as otherwise provided in section 6104 and the regulations thereunder.

In promulgating § 1.6033-2(a)(2)(ii)(J), the Treasury Department and the IRS noted the provision clarifies that Form 4720 (relating to certain excise tax liabilities under chapter 42), when filed by a private foundation, is part of the information return required under section 6033 as well as a tax return required under section 6011. Accordingly, Form 4720 filed by a private foundation is information required by section 6033 and the regulations thereunder and thus is disclosable under section 6104, whereas Form 4720 filed by a taxpayer other than a private foundation is not information required by section 6033 and the regulations thereunder and thus is not disclosable under section 6104. See TD 7785, 46 FR 38507 (July 28, 1981).

¹ Form 4720 is filed by taxpayers reporting tax liabilities under sections 170(f)(10), 664(c)(2), 4911, 4912, 4941, 4942, 4943, 4944, 4945, 4955, 4958, 4959, 4960, 4965, 4966, 4967, and 4968 of the Code.

SECTION 3. MANDATORY ELECTRONIC FILING OF FORM 4720

On July 1, 2019, the TFA was enacted into law. Section 3101 of the TFA is effective for taxable years beginning on or after July 2, 2019. Section 3101(a) of the TFA amends section 6033(n) of the Code to provide that any exempt organization required to file a return under section 6033 of the Code must file such return in electronic form. Section 3101(c) of the TFA amends section 6104(b) of the Code to provide that any annual return required to be filed electronically under section 6033(n) must be made available by the Secretary to the public as soon as practicable in a machine-readable format. Section 3101(d)(1) of the TFA provides that, in general, these amendments apply to taxable years beginning after the date of enactment of the TFA. However, section 3101(d)(2) of the TFA gives the Secretary authority to delay the application of these amendments if the Secretary determines the application of the amendments would cause undue burden without a delay but the delayed applicability date must not be later than taxable years beginning on or after July 1, 2021.

As described in section 2 of this notice, Form 4720, when filed by a private foundation, is part of the information return required under section 6033, as well as a tax return required under section 6011. Accordingly, Form 4720 filed by a private foundation as part of the Form 990-PF is required to be electronically filed as a return required under section 6033(n). The IRS is modifying Form 4720 so that private foundations can electronically file the form in accordance with the TFA's electronic filing mandate. The modifications to Form 4720 are also necessary to meet the TFA's requirement under section 6104(b) that the Secretary must make available to the public in machine readable format any annual return to be filed electronically under section 6033(n). See section 4 of this notice for the timing implications of these modifications.

Currently, under § 53.6011-1(c) a disqualified person may designate the private foundation's Form 4720 as the disqualified person's return for purposes of complying with the filing requirement under § 53.6011-1(b), provided all persons share

the same taxable year. The current regulation assumes the ability of multiple taxpayers to sign the same paper copy of Form 4720. However, that flexibility no longer exists for private foundations and their disqualified persons because section 6033(n) requires private foundations to file Forms 4720 electronically and the IRS system allows for only one taxpayer per return. Thus, the TFA has rendered § 53.6011-1(c), allowing for joint Form 4720 submissions, no longer applicable to private foundations once the Form 4720 is required to be electronically filed by private foundations. Accordingly, the Treasury Department and the IRS intend to propose the removal of § 53.6011-1(c) in a future notice of proposed rulemaking.

SECTION 4. DELAY OF APPLICATION OF ELECTRONIC FILING MANDATE FOR FORMS 4720

The IRS expects that a modified paper version of the Form 4720 will be available for use at the beginning of 2021. Under the authority granted to the Secretary in section 3101(d)(2) of the TFA, private foundations may continue to file the paper version of the Form 4720 until electronic filing of Form 4720 is available and the IRS announces that electronic filing of the Form 4720 is required (expected to be in early 2021). Once electronic filing is required, any Forms 4720 filed by private foundations after such date must be filed electronically in accordance with the instructions to Form 4720 prescribed by the IRS.

SECTION 5. EFFECTIVE DATE

This notice is effective on January 11, 2021, the publication date of IRB 2021-2.

SECTION 6. DRAFTING INFORMATION

The principal author of this notice is William Riker of the Office of Associate Chief Counsel (Employee Benefits, Exempt Organizations, and Employment Taxes). For further information regarding this notice, please contact William Riker at (202) 317-5800 or Dave Rifkin at (202) 317-4541 (not toll-free numbers).

Extension of Temporary Relief from the Physical Presence Requirement for Spousal Consents Under Qualified Retirement Plans

Notice 2021-03

I. PURPOSE

In response to the continuing public health emergency caused by the Coronavirus Disease 2019 (COVID-19) pandemic, and the related social distancing that has been implemented, this notice extends from January 1, 2021, through June 30, 2021, the temporary relief provided in Notice 2020-42, 2020-26 I.R.B. 986, from the physical presence requirement in Treasury Regulation § 1.401(a)-21(d)(6) for participant elections required to be witnessed by a plan representative or a notary public, including spousal consent required under § 417 of the Internal Revenue Code, and solicits comments with respect to the relief.

II. BACKGROUND

On March 13, 2020, the President determined that the COVID-19 pandemic was of sufficient severity and magnitude to warrant an emergency determination under the Robert T. Stafford Disaster Relief and Emergency Assistance Act, 42 U.S.C. 5121-5207. Providing alternative procedures for notarization and consent related to plan distributions that do not require physical presence is an appropriate emergency protective measure during this declared emergency period and is consistent with the physical distancing procedures implemented by the states.

Section 1.401(a)-21 sets forth standards for the use of an electronic medium to provide applicable notices to recipients or to make participant elections with respect to a retirement plan, an employee benefit arrangement, or an individual retirement plan. Section 1.401(a)-21(e) (6) defines a participant election as any consent, election, request, agreement, or similar communication made by or from a participant, beneficiary, alternate payee, or an individual entitled to benefits

under a retirement plan, employee benefit arrangement, or individual retirement plan. Section 1.401(a)-21(d) sets forth the following conditions for participant elections:

(1) The individual must be effectively able to access the electronic medium used to make the participant election;

(2) The electronic system must be reasonably designed to preclude any person other than the appropriate individual from making the participant election;

(3) The electronic system must provide the individual making the participant election with a reasonable opportunity to review, confirm, modify, or rescind the terms of the election before it becomes effective; and

(4) The individual making the participant election, within a reasonable time, must receive confirmation of the election through either a written paper document or an electronic medium under a system that satisfies the applicable notice requirements under § 1.401(a)-21.

The participant election rules in § 1.401(a)-21(d) apply to plans that are subject to the qualified joint and survivor (QJSA) requirements of § 417. Accordingly, for a plan subject to the QJSA requirements, a participant's consent to a distribution may be provided through the use of electronic media if the plan complies with the standards described in § 1.401(a)-21(d), provided that the participant also obtains a valid spousal consent, if applicable.

Section 417 requires spousal consent to a waiver of a QJSA, which includes the waiver of a QJSA as part of a request for a plan distribution or a plan loan. Section 417 further requires that the spousal consent be witnessed by a plan representative or a notary public. Section 1.401(a)-21(d)(6)(i) provides that, in the case of a participant election that is required to be witnessed by a plan representative or a notary public (such as a spousal consent to a waiver of a QJSA under § 417), the signature of the individual making the participant election must be witnessed in the physical presence of a plan representative or a notary public. Section 1.401(a)-

21(d)(6)(ii) provides that, if the signature is witnessed in the physical presence of a notary public, an electronic signature acknowledging the signature (in accordance with section 101(g) of the Electronic Signatures in Global and National Commerce Act, Pub. L. 106-229, 114 Stat. 464 (2000) (E-SIGN),¹ and applicable state law for notaries public) will not be denied legal effect.

Section 1.401(a)-21(d)(6)(iii) provides that the Commissioner may provide in guidance published in the Internal Revenue Bulletin that the use of procedures under an electronic system is deemed to satisfy the physical presence requirement, but only if those procedures with respect to the electronic system provide the same safeguards for participant elections as are provided through the physical presence requirement.

Section 1.401(a)-21(d) permits electronic notarization of participant elections. However, the physical presence requirement in § 1.401(a)-21(d)(6) would preclude the use of remote notarizations of participant elections, including spousal consents.

Remote electronic notarizations differ from electronic notarizations in that remote electronic notarizations generally are conducted remotely over the internet using digital tools and live audio-video technologies, whereas electronic notarizations can be signed electronically but still require that certain signatures be witnessed in the physical presence of a notary public or plan representative. The Department of the Treasury (Treasury Department) and the Internal Revenue Service (IRS) received several requests from stakeholders to permit remote electronic notarization of spousal consents for plan loans and distributions during the COVID-19 pandemic. These stakeholders stated that due to the social distancing measures with respect to the COVID-19 pandemic, the physical presence requirement in § 1.401(a)-21(d)(6) makes it difficult, if not impossible, for a participant to receive a plan distribution or plan loan (or for a qualified individual to receive a coronavirus-related distribution or plan loan) for which spousal con-

sent is required. While recognizing the need for relief, other stakeholders requested that any relief take into account spousal protections, including limiting the relief solely to the physical presence requirement and making the relief temporary.

Notice 2020-42 provides temporary relief from the physical presence requirement in § 1.401(a)-21(d)(6) for any participant election witnessed by a notary public of a state that permits remote electronic notarization or by a plan representative, if the requirements of section III of Notice 2020-42 are satisfied. The temporary relief provided in Notice 2020-42 covers the period from January 1, 2020, through December 31, 2020. The Treasury Department and the IRS have received requests from stakeholders to make the relief provided in Notice 2020-42 permanent or, at a minimum, to extend the temporary relief period, in light of the continuing public health emergency caused by the COVID-19 pandemic.

III. GRANT OF RELIEF

For the period from January 1, 2021, through June 30, 2021, this notice extends the temporary relief provided in Notice 2020-42 from the physical presence requirement in § 1.401(a)-21(d)(6), if the related requirements in subsection A or B of this section III are satisfied. In particular, this notice extends the following two types of temporary relief (under terms that are identical to the temporary relief provided in Notice 2020-42):

(1) temporary relief from the physical presence requirement for any participant election witnessed by a notary public of a state that permits remote electronic notarization, and

(2) temporary relief from the physical presence requirement for any participant election witnessed by a plan representative.

During this temporary relief period, a participant is still able to have a participant election witnessed in the physical presence of a notary public and have that participant election be accepted by a plan in accordance with § 1.401(a)-21(d)(6)(i).

¹ Section 101(g) of E-SIGN provides that “[i]f a statute, regulation, or other rule of law requires a signature or record relating to a transaction in or affecting interstate or foreign commerce to be notarized, acknowledged, verified, or made under oath, that requirement is satisfied if the electronic signature of the person authorized to perform those acts, together with all other information required to be included by other applicable statute, regulation, or rule of law, is attached to or logically associated with the signature or record.”

A. Temporary Relief from the Physical Presence Requirement for any Participant Election Witnessed by a Notary Public

In the case of a participant election witnessed by a notary public, for the period from January 1, 2021, through June 30, 2021, the physical presence requirement in § 1.401(a)-21(d)(6) is deemed satisfied for an electronic system that uses remote notarization if executed via live audio-video technology that otherwise satisfies the requirements of participant elections under § 1.401(a)-21(d)(6) and is consistent with state law requirements that apply to the notary public.

B. Temporary Relief from the Physical Presence Requirement for any Participant Election Witnessed by a Plan Representative

In the case of a participant election witnessed by a plan representative, for the period from January 1, 2021, through June 30, 2021, the physical presence requirement in § 1.401(a)-21(d)(6) is deemed satisfied for an electronic system if the electronic system using live audio-video technology satisfies the following requirements:

- (1) The individual signing the participant election must present a valid photo ID to the plan representative during the live audio-video conference, and may not merely transmit a copy of the photo ID prior to or after the witnessing;
- (2) The live audio-video conference must allow for direct interaction between the individual and the plan representative (for example, a pre-recorded video of the person signing is not sufficient);
- (3) The individual must transmit by fax or electronic means a legible copy of the signed document directly to the plan representative on the same date it was signed; and
- (4) After receiving the signed document, the plan representative must acknowledge that the signature has been witnessed by the plan representative in accordance with the requirements of this notice and transmit the signed document, including the acknowledgement, back to the individual under a system that satisfies the applicable notice requirements under § 1.401(a)-21(c).

IV. PAPERWORK REDUCTION ACT

The collection of information contained in this notice has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545-1632. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid OMB control number.

The collection of information is in section III.B of this notice. One of the conditions for receiving temporary relief from the physical presence requirement in § 1.401(a)-21(d) is that the plan representative acknowledge that he or she has witnessed the signature and transmit the signed document, including the acknowledgement, back to the person under a system that satisfies the applicable notice requirements under § 1.401(a)-21. This condition is similar to the confirmation requirement for participant elections in § 1.401(a)-21(d), requiring that the individual making a participant election, within a reasonable time, receive a confirmation of the election through either a written paper document or an electronic medium under a system that satisfies the applicable notice requirements under § 1.401(a)-21(c). Notice 2020-42 included a statement that it had been determined that the plan representative's acknowledgement that he or she witnessed the signature of the participant election is a minor modification to the control number 1545-1632 and does not result in any additional paperwork burden. For the same reason, this extension of the temporary relief from the physical presence requirement does not result in any additional paperwork burden.

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 § 6103.

V. REQUEST FOR COMMENTS

The Treasury Department and the IRS invite comments relating to the temporary relief from the physical presence require-

ment in § 1.401(a)-21(d)(6). In particular, the Treasury Department and the IRS request comments on whether relief from the physical presence requirement should be made permanent and, if made permanent, what, if any, procedural safeguards are necessary in order to reduce the risk of fraud, spousal coercion, or other abuse in the absence of a physical presence requirement. Any permanent modification of the physical presence requirement in § 1.401(a)-21(d)(6)(i) would be made through the regulatory process that is subject to notice and comment. Thus, if the Treasury Department and IRS decide to propose modifying the physical presence requirement on a permanent basis, there will be additional opportunity for comment.

Comments should be submitted in writing and should include a reference to Notice 2021-03. Comments may be submitted in one of two ways:

- (1) Electronically via the Federal eRulemaking Portal at www.regulations.gov (type IRS-2020-0049 in the search field on the [regulations.gov](http://www.regulations.gov) homepage to find this notice and submit comments).
- (2) Alternatively, by mail to: Internal Revenue Service, Attn: CC:PA:LPD:PR (Notice 2021-03), Room 5203, P.O. Box 7604, Ben Franklin Station, Washington D.C. 20044.

All commenters are strongly encouraged to submit public comments electronically. The IRS expects to have limited personnel available to process public comments that are submitted on paper through mail. Until further notice, any comments submitted on paper will be considered to the extent practicable. The Treasury Department and the IRS will publish for public availability any comment submitted electronically, and to the extent practicable on paper, to its public docket.

VI. EFFECT ON OTHER DOCUMENTS

Notice 2020-42 is modified.

VII. DRAFTING INFORMATION

The principal authors of this notice are Arslan Malik and Pamela R. Kinard of the Office of the Associate Chief Counsel (Employee Benefits, Exempt Orga-

nizations, and Employment Taxes). For further information regarding this notice, contact Arslan Malik at (202) 317-6700 or Pamela R. Kinard at (202) 317-6000 (not toll-free numbers).

Final Extension of Temporary Relief for Fuel Removals Destined for Nontaxable Use Due to West Shore Pipeline Shutdown

Notice 2021-04

SECTION 1. PURPOSE

This notice provides the final extension of the temporary dyed fuel relief initially provided for the period beginning on October 31, 2017, and ending on May 3, 2018, in section 3.02 of Notice 2017-30, 2017-21 I.R.B. 1248. The temporary dyed fuel relief was extended (i) through December 31, 2018, by section 3 of Notice 2018-39, 2018-20 I.R.B. 582, (ii) through December 31, 2019, by section 3 of Notice 2019-04, 2019-02 I.R.B. 282, and (iii) through December 31, 2020, by section 3 of Notice 2020-04, 2020-04 I.R.B. 380. The final extension of the temporary dyed fuel relief will begin on January 1, 2021, and end on December 31, 2021. A claimant may submit a refund claim for the Internal Revenue Code § 4081(a)(1) tax imposed on undyed diesel fuel and kerosene for fuel that is (i) removed from a Milwaukee or Madison terminal; (ii) entered into a Green Bay terminal within 24 hours of removal from the Milwaukee or Madison terminal; and (iii) subsequently dyed and removed from that Green Bay terminal.

SECTION 2. BACKGROUND

The West Shore Pipeline is a 650-mile pipeline system that transported refined petroleum products to the northeastern part of Wisconsin for over 50 years. The West Shore Pipeline was the only pipeline serving Green Bay and northeastern Wisconsin. The West Shore Pipeline segment

between Milwaukee and Green Bay closed on March 10, 2016, for repairs, testing, and inspections. On June 22, 2016, this segment of the West Shore Pipeline was shut down indefinitely after integrity concerns were detected. Due to this unanticipated complete shut down and the then uncertain future of this section of the pipeline, Green Bay and northeast Wisconsin expected to have material fuel shortages for a relatively long period of time. In response to this shut down and the expected fuel shortages, the Governor of Wisconsin issued Executive Orders on May 6, 2016, September 7, 2016, and November 4, 2016, declaring energy emergencies. On April 21, 2017, the Wisconsin Department of Administration issued a statement that the West Shore Pipeline Company notified the state that the company would not replace the aging pipeline that runs from north of Milwaukee to Green Bay. A Wisconsin Department of Administration official said the state would continue working with its partners to develop a long-term solution.

Since the March 2016 shutdown of this segment of the West Shore Pipeline, fuel has been transported to Green Bay via vessel, or has been removed from the Milwaukee or Madison terminals and then transported via tank trucks and/or rail cars to Green Bay terminals. The Department of the Treasury (Treasury Department) and the Internal Revenue Service (IRS) recognized in Notice 2017-30 that there is no mechanism under existing law that permits a refund of the § 4081(a)(1) tax imposed upon removal of taxable fuel from a Milwaukee terminal when that fuel is transported to and entered into a Green Bay terminal, and then removed from the Green Bay terminal as dyed fuel destined for a nontaxable use. Accordingly, the Treasury Department and the IRS provided administrative relief in the form of a temporary refund mechanism for the first tax paid on the taxable fuel when it is removed from a Milwaukee terminal, transported to and entered into a Green Bay Terminal, and later removed from that Green Bay terminal as dyed fuel destined for a nontaxable use. This temporary relief was available for the period beginning on October 31, 2017, and ending on May 3, 2018. Section 3 of

Notice 2018-39 extended this temporary relief for the period beginning on May 4, 2018, and ending on December 31, 2018. Additionally, Notice 2018-39 expanded the temporary relief to include refund claims for fuel that is taxed on removal from a Madison terminal, transported to a Green Bay terminal, and then removed from that Green Bay terminal as dyed fuel. The expanded temporary dyed fuel relief was extended through December 31, 2019, by section 3 of Notice 2019-04, 2019-02 I.R.B. 282, and was further extended through December 31, 2020, by section 3 of Notice 2020-04, 2020-04 I.R.B. 380.

The temporary administrative relief provided during the years following the permanent shutdown of the segment of the West Shore Pipeline between Milwaukee and Green Bay has provided the affected position holders time to renegotiate relevant contracts, otherwise adopt business solutions pertaining to the shipment of fuel by vessel to Green Bay or by truck or rail from the Milwaukee and Madison terminals to the Green Bay terminals, and pursue legislative solutions. Accordingly, this is the final extension of the temporary administrative relief for fuel that is (i) removed from a Milwaukee or Madison terminal; (ii) entered into a Green Bay terminal within 24 hours of removal from the Milwaukee or Madison terminal; and (iii) subsequently dyed and removed from that Green Bay terminal for a nontaxable use.

Upon expiration of this temporary administrative relief, a payment equal to the aggregate amount of tax imposed on such fuel under § 4081 may be available to the ultimate purchaser of the fuel under § 6427(l)(1). Under § 6427(l)(1), if any diesel fuel on which tax has been imposed under § 4081 is used by any person in a nontaxable use, the Secretary of the Treasury or his delegate (Secretary) shall pay (without interest) to the ultimate purchaser of the fuel an amount equal to the amount of tax imposed. Section 48.6427-8(b)(1)(ii) provides that a claim with respect to diesel fuel under § 6427(l)(1) is allowable if, among other conditions, the claimant produced or bought the fuel and did not sell it in the United States.

SECTION 3. FINAL EXTENSION OF TEMPORARY DYED FUEL RELIEF

For the period beginning on January 1, 2021, and ending on December 31, 2021, if any person (that is, the position holder) that removes diesel fuel or kerosene that satisfies the requirements of § 4082 from a Green Bay terminal establishes to the satisfaction of the Secretary that a prior tax was paid with respect to the removal of such fuel from a Milwaukee or Madison terminal, then an amount equal to the prior tax paid shall be allowed as a refund (without interest) to the position holder in the same manner as if it were an overpayment of tax imposed by § 4081.

Notice 2017-59, 2017-45 I.R.B. 484, provides guidance on how persons eligible for relief under section 3.02 of Notice 2017-30 may submit claims for refund. Sections 3.02, 3.03, and 3.04 of Notice 2017-59 describe the conditions and procedures required to make such claims.

The relief described in this section is not available with respect to any transaction for which one or more conditions set forth in section 3.02 of Notice 2017-59 are not satisfied or for any refund claim that fails to comply with the procedures set forth in sections 3.03 and 3.04 of Notice 2017-59. For purposes of this notice, any reference in Notice 2017-59 to removals from a Milwaukee terminal shall be read to also include removals from a Madison terminal.

SECTION 4. EFFECTIVE DATE

The temporary dyed fuel relief described in section 3 of this notice applies to removals of dyed diesel fuel and kerosene from Green Bay terminals on or after January 1, 2021, and on or before December 31, 2021.

SECTION 5. DRAFTING INFORMATION

The principal author of this notice is Natalie Payne of the Office of Associate Chief Counsel (Passthroughs & Special Industries). For further information regarding this notice contact Ms. Payne on (202) 317-6855 (not a toll-free number).

Part IV

Notice of Proposed Rulemaking

Grandfathered Group Health Plans and Grandfathered Group Health Insurance Coverage

REG-130081-19

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 54

DEPARTMENT OF LABOR Employee Benefits Security Administration 29 CFR Part 2590

DEPARTMENT OF HEALTH AND HUMAN SERVICES 45 CFR Part 147

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

ACTION: Final rules.

SUMMARY: This document includes final rules regarding grandfathered group health plans and grandfathered group health insurance coverage that amend current rules to provide greater flexibility for certain grandfathered health plans to make changes to certain types of fixed-amount cost-sharing requirements without causing a loss of grandfather status under the Patient Protection and Affordable Care Act.

DATES: *Effective Date:* These regulations are effective January 14, 2021.

Applicability Date: These regulations are applicable June 15, 2021.

FOR FURTHER INFORMATION CONTACT: William Fischer, Internal Revenue Service, Department of the Treasury, (202) 317-5500.

Matthew Litton and Chelsea Cerio, Employee Benefits Security Administration, Department of Labor, (202) 693-8335.

Cam Clemmons, Centers for Medicare & Medicaid Services, Department of Health and Human Services, (301) 492-4400.

Customer Service Information:

Individuals interested in obtaining information from the Department of Labor (DOL) concerning employment-based health coverage laws may call the Employee Benefits Security Administration (EBSA) Toll-Free Hotline at 1-866-444-EBSA (3272) or visit the DOL's web site (www.dol.gov/ebsa). In addition, information from the Department of Health and Human Services (HHS) regarding private health insurance coverage and non-federal governmental group health plans can be found on the Centers for Medicare & Medicaid Services (CMS) web site (www.cms.gov/ccio), and information on healthcare reform can be found at www.HealthCare.gov.

SUPPLEMENTARY INFORMATION:

I. Background

A. Purpose

On January 20, 2017, the President issued Executive Order 13765, “Minimizing the Economic Burden of the Patient Protection and Affordable Care Act Pending Repeal” (82 FR 8351) “to minimize the unwarranted economic and regulatory burdens of the [Patient Protection and Affordable Care Act (Pub. L. 111-148) and the Health Care and Education Reconciliation Act of 2010 (Pub. L. 111-152) (collectively, PPACA), as amended].” To

meet these objectives, the President directed that the executive departments and agencies with authorities and responsibilities under PPACA, “to the maximum extent permitted by law . . . shall exercise all authority and discretion available to them to waive, defer, grant exemptions from, or delay the implementation of any provision or requirement of [PPACA] that would impose a fiscal burden on any state or a cost, fee, tax, penalty, or regulatory burden on individuals, families, healthcare providers, health insurers, patients, recipients of healthcare services, purchasers of health insurance, or makers of medical devices, products, or medications.”

HHS, DOL, and the Department of the Treasury (collectively, the Departments) share interpretive jurisdiction over section 1251 of PPACA, which generally provides that certain group health plans and health insurance coverage existing as of March 23, 2010, the date of enactment of PPACA (referred to collectively in the statute as grandfathered health plans), are subject to only certain provisions of PPACA. Consistent with the objectives of Executive Order 13765, on February 25, 2019, the Departments issued a request for information regarding grandfathered group health plans and grandfathered group health insurance coverage (2019 RFI).¹ The purpose of the 2019 RFI was to gather input from the public in order to better understand the challenges that group health plans and group health insurance issuers face in avoiding a loss of grandfather status, and to determine whether there are opportunities for the Departments to assist such plans and issuers, consistent with the law, in preserving the grandfather status of group health plans and group health insurance coverage in ways that would benefit plan participants and beneficiaries, employers, employee organizations, and other stakeholders.

Based on feedback received from stakeholders who submitted comments in response to the 2019 RFI, the Departments issued a notice of proposed rulemaking on July 15, 2020 (referred to as the 2020 proposed rules), that would, if finalized,

¹ 84 FR 5969 (Feb. 25, 2019).

amend current rules to provide greater flexibility for certain grandfathered health plans to make changes to certain types of cost-sharing requirements without causing a loss of grandfather status.² After careful consideration of the comments received, the Departments are issuing final rules that adopt the proposed amendments without substantive change. In the Departments' view, these amendments are appropriate because they will enable these plans to continue offering affordable coverage while also enhancing their ability to respond to rising healthcare costs. In some cases, the amendments would also ensure that the plans are able to comply with minimum cost-sharing requirements for high deductible health plans (HDHPs) so enrolled individuals are eligible to contribute to health savings accounts (HSAs).

The final rules only address the requirements for grandfathered group health plans and grandfathered group health insurance coverage and do not apply to or otherwise change the current requirements applicable to grandfathered individual health insurance coverage. With respect to individual health insurance coverage, it is the Departments' understanding that the number of individuals with grandfathered individual health insurance coverage has declined each year since PPACA was enacted. As one comment received in response to the 2019 RFI noted, this decline in enrollment in grandfathered individual health insurance coverage will continue due to natural churn, because most consumers stay in the individual market for less than 5 years.³ Moreover, compared to the number of individuals in grandfa-

thered group health plans and grandfathered group health insurance coverage, only a small number of individuals are enrolled in grandfathered individual health insurance coverage.⁴ The Departments are therefore of the view that any amendments to requirements for grandfathered individual health insurance coverage would be of limited utility.

B. Grandfathered Group Health Plans and Grandfathered Group Health Insurance Coverage

Section 1251 of PPACA provides that grandfathered health plans are not subject to certain provisions of PPACA for as long as they maintain their status as grandfathered health plans.⁵ For example, grandfathered health plans are subject neither to the requirement to cover certain preventive services without cost sharing under section 2713 of the Public Health Service Act (PHS Act), enacted by section 1001 of PPACA, nor to the annual limitation on cost sharing set forth under section 1302(c) of PPACA and section 2707(b) of the PHS Act, enacted by section 1201 of PPACA. If a plan were to lose its grandfather status, it would be required to comply with both provisions, in addition to several other requirements.

On June 17, 2010, the Departments issued interim final rules with request for comments implementing section 1251 of PPACA.⁶ On November 17, 2010, the Departments issued an amendment to the interim final rules with request for comments to permit certain changes in policies, certificates, or contracts of insurance

without a loss of grandfather status.⁷ Also, over the course of 2010 and 2011, the Departments released Affordable Care Act Implementation Frequently Asked Questions (FAQs) Parts I, II, IV, V, and VI to answer questions related to maintaining a plan's status as a grandfathered health plan.⁸ After consideration of comments and feedback received from stakeholders, the Departments issued regulations on November 18, 2015, which finalized the interim final rules without substantial change and incorporated the clarifications that the Departments had previously provided in other guidance (2015 final rules).⁹

In general, under the 2015 final rules, a group health plan or group health insurance coverage is considered grandfathered if it was in existence, and has continuously provided coverage for someone (not necessarily the same person, but at all times at least one person) since March 23, 2010, provided the plan (or its sponsor) or issuer has not taken certain actions resulting in the plan relinquishing grandfather status.

Under the 2015 final rules, certain changes to a group health plan or coverage do not result in a loss of grandfather status. For example, new employees and their families may enroll in a group health plan or group health insurance coverage without causing a loss of grandfather status. Further, the addition of a new contributing employer or a new group of employees of an existing contributing employer to a grandfathered multiemployer health plan will not affect the plan's grandfather status. Also, grandfather status is determined separately for each benefit package option available under a group health plan

² 85 FR 42782 (July 15, 2020).

³ The cause of this churn varies. For example, beginning a new job that offers group health coverage may result in a transition from the individual market to group coverage. Eligibility for Medicaid or Medicare can also result in a consumer leaving the individual market.

⁴ HHS estimates that less than seven percent of enrollees in grandfathered plans have individual market coverage. This estimate is based on analysis of enrollment data issuers submitted in the HHS Health Insurance and Oversight System (HIOS) and the CMS External Data Gathering Environment (EDGE) for the 2018 plan year, as well as Kaiser Family Foundation estimates regarding the percentage of enrollees with employer-sponsored coverage that are covered by a grandfathered health plan.

⁵ For a list of the market reform provisions applicable to grandfathered health plans under title XXVII of the PHS Act that PPACA added or amended and that were incorporated into the Employee Retirement Income Security Act of 1974 (ERISA) and the Internal Revenue Code of 1986 (the Code), visit <https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/laws/affordable-care-act/for-employers-and-advisers/grandfathered-health-plans-provisions-summary-chart.pdf>.

⁶ 75 FR 34538 (June 17, 2010).

⁷ 75 FR 70114 (Nov. 17, 2010).

⁸ See Affordable Care Act Implementation FAQs Part I, available at <https://www.dol.gov/sites/default/files/ebsa/about-ebsa/our-activities/resource-center/faqs/aca-part-i.pdf> and https://www.cms.gov/CCIIO/Resources/Fact-Sheets-and-FAQs/aca_implementation_faqs.html; Affordable Care Act Implementation FAQs Part II, available at <https://www.dol.gov/sites/default/files/ebsa/about-ebsa/our-activities/resource-center/faqs/aca-part-ii.pdf> and https://www.cms.gov/CCIIO/Resources/Fact-Sheets-and-FAQs/aca_implementation_faqs2.html; Affordable Care Act Implementation FAQs Part IV, available at <https://www.dol.gov/sites/default/files/ebsa/about-ebsa/our-activities/resource-center/faqs/aca-part-iv.pdf> and https://www.cms.gov/CCIIO/Resources/Fact-Sheets-and-FAQs/aca_implementation_faqs4.html; Affordable Care Act Implementation FAQs Part V, available at <https://www.dol.gov/sites/default/files/ebsa/about-ebsa/our-activities/resource-center/faqs/aca-part-v.pdf> and https://www.cms.gov/CCIIO/Resources/Fact-Sheets-and-FAQs/aca_implementation_faqs5.html; and Affordable Care Act Implementation FAQs Part VI, available at <https://www.dol.gov/sites/default/files/ebsa/about-ebsa/our-activities/resource-center/faqs/aca-part-vi.pdf> and https://www.cms.gov/CCIIO/Resources/Fact-Sheets-and-FAQs/aca_implementation_faqs6.html.

⁹ 80 FR 72192 (Nov. 18, 2015), codified at 26 CFR 54.9815-1251, 29 CFR 2590.715-1251, and 45 CFR 147.140.

or coverage; thus, if any benefit package under the plan or coverage loses its grandfather status, it will not affect the grandfather status of the other benefit packages, provided that any other changes do not exceed the other standards that cause a plan to relinquish grandfather status, as explained further in this preamble.

The 2015 final rules specify the circumstances under which changes to the terms of a plan or coverage cause the plan or coverage to cease to be a grandfathered health plan. Specifically, the regulations outline certain changes to benefits, cost-sharing requirements, and contribution rates that will cause a plan or coverage to relinquish its grandfather status. There are six types of changes (measured from March 23, 2010) that will cause a group health plan or health insurance coverage to cease to be grandfathered:

1. The elimination of all or substantially all benefits to diagnose or treat a particular condition;
2. Any increase in a percentage cost-sharing requirement (such as coinsurance);
3. Any increase in a fixed-amount cost-sharing requirement (other than a copayment) (such as a deductible or out-of-pocket maximum) that exceeds certain thresholds;
4. Any increase in a fixed-amount copayment that exceeds certain thresholds;
5. A decrease in contribution rate by an employer or employee organization toward the cost of coverage of any tier of coverage for any class of similarly situated individuals by more than five percentage points below the rate for the coverage period that includes March 23, 2010; or
6. The imposition of annual limits on the dollar value of all benefits for group health plans and insurance coverage that did not impose such a limit prior to March 23, 2010.

The 2015 final rules provide different thresholds for the increases to different types of cost-sharing requirements that will cause a loss of grandfather status. The nominal dollar amount of a coinsurance obligation automatically rises when the cost of the healthcare benefit subject to the coinsurance obligation increases, so changes to the level of coinsurance (such as modifying a requirement that the patient pay 20 percent to a requirement that the

patient pay 30 percent of inpatient surgery costs) can significantly alter the balance of financial obligations between participants and beneficiaries and a plan or health insurance coverage. On the other hand, fixed-amount cost-sharing requirements (such as copayments and deductibles) do not automatically rise when healthcare costs increase. This means that changes to fixed-amount cost-sharing requirements (for example, modifying a \$35 copayment to a \$40 copayment for outpatient doctor visits) may be reasonable to keep pace with the rising cost of medical items and services. Accordingly, under the 2015 final rules, any increase in a percentage cost-sharing requirement (such as coinsurance) causes a plan or health insurance coverage to cease to be a grandfathered health plan. With respect to fixed-amount cost-sharing requirements, however, there are two standards for permitted increases, one for fixed-amount cost-sharing requirements other than copayments (for example, deductibles and out-of-pocket maximums) and another for copayments.

With respect to fixed-amount cost-sharing requirements other than copayments, a plan or coverage ceases to be a grandfathered health plan if there is an increase, since March 23, 2010, that is greater than the maximum percentage increase. The 2015 final rules define the maximum percentage increase as medical inflation (from March 23, 2010) plus 15 percentage points. For this purpose, medical inflation is defined by reference to the overall medical care component of the Consumer Price Index for All Urban Consumers, unadjusted (CPI-U), published by the DOL using the 1982–1984 base of 100.

For fixed-amount copayments, a plan or coverage ceases to be a grandfathered health plan if there is an increase, since March 23, 2010, in the copayment that exceeds the greater of (1) the maximum percentage increase (calculated in the same manner as for fixed amount cost-sharing requirements other than copayments) or (2) five dollars (as increased by medical inflation).

For any change that causes a loss of grandfather status under the 2015 final rules, the plan or coverage will cease to be a grandfathered plan when the change becomes effective, regardless of when the change is adopted.

In addition, the 2015 final rules require that a grandfathered plan or coverage both include a statement in any summary of benefits provided under the plan that it believes the plan or coverage is a grandfathered health plan and provide contact information for questions and complaints. Failure to provide this disclosure results in a loss of grandfather status. The 2015 final rules further provide that, once grandfather status is relinquished, there is no opportunity to regain it.

C. 2019 Request for Information

It is the Departments' understanding that the number of grandfathered group health plans and grandfathered group health insurance policies has declined each year since the enactment of PPACA, but many employers continue to maintain grandfathered group health plans and coverage. That a significant number of grandfathered group health plans and coverage remain indicates that some employers and issuers have found value in preserving grandfather status. Accordingly, on February 25, 2019, the Departments published the 2019 RFI to gather input from the public in order to better understand the challenges that group health plans and group health insurance issuers face in avoiding the loss of grandfather status and to determine whether there are opportunities for the Departments to assist such plans and issuers, consistent with the law, in preserving the grandfather status of group health plans and group health insurance coverage in ways that would benefit plan participants and beneficiaries, employers, employee organizations, and other stakeholders.

Comments submitted in response to the 2019 RFI provided information regarding grandfathered health plans that helped inform the 2020 proposed rules. Commenters shared data regarding the prevalence of grandfathered group health plans and grandfathered group health insurance coverage, insights regarding the impact that grandfathered plans have had in terms of delivering benefits to participants and beneficiaries at a lower cost than non-grandfathered plans, and suggestions for potential amendments to the Departments' 2015 final rules that would provide more flexibility for a plan or coverage to retain grandfather status.

Several commenters directed the Departments' attention to a Kaiser Family Foundation survey, which indicates that one out of every five firms that offered health benefits in 2018 offered at least one grandfathered health plan, and 16 percent of covered workers were enrolled in a grandfathered group health plan that year.¹⁰ One commenter indicated the incidence of grandfathered plan status differs by various types of plan sponsors. Another commenter cited survey data released in 2018 by the International Foundation of Employee Benefit Plans, which indicated that 57 percent of multiemployer plans are grandfathered, compared to 20 percent of other private-sector plans and 30 percent of public-sector plans. However, a professional association with members who work with employer groups on health plan design and administration commented that their members have found far fewer grandfathered plans than survey results suggest exist and suggested that very large employers with self-funded plans may sponsor a disproportionate share of grandfathered plans, as well as that some employers that have "grandmothered" plans or that previously had grandfathered plans may unintentionally be reporting incorrectly in surveys that they still sponsor grandfathered plans.¹¹

Some commenters stated that grandfathered health plans are less comprehensive and provide fewer consumer protections than non-grandfathered plans; thus, these commenters opined that the Departments should not amend the 2015 final rules to provide greater flexibility for a plan or coverage to maintain grandfather status. Other commenters noted, however, that grandfathered plans often have lower premiums and cost-sharing requirements than non-grandfathered plans. One commenter gave examples of premium increases ranging from 10 percent to 40 percent that grandfathered plan par-

ticipants would experience if they transitioned to non-grandfathered group health plans. Several commenters also stated that grandfathered health plans do in fact offer comprehensive benefits and in some cases are even more generous than certain non-grandfathered plans that are subject to all the requirements of PPACA. Some commenters also stated that their grandfathered plans offer more robust provider networks than other coverage options that are available to them or that access to a grandfathered plan ensures that they are able to keep receiving care from current in-network providers.

Commenters who supported allowing greater flexibility for grandfathered health plans offered a range of suggestions regarding how the Departments should amend the 2015 final rules. For example, several commenters requested additional flexibility regarding plan or coverage changes that would constitute an elimination of substantially all benefits to diagnose or treat a condition, stating that it is often difficult to discern what constitutes a benefit reduction given that the regulations apply a "facts and circumstances" standard. Some commenters requested flexibility to make certain changes so long as the grandfathered plan or coverage's actuarial value is not affected. Some commenters also stated that the 2015 final rules should be amended to permit decreases in contribution rates by employers and employee organizations by more than five percentage points to account for employers experiencing a business change or economic downturn.

Commenters also suggested amendments relating to the permitted changes in cost-sharing requirements for grandfathered plans. These commenters generally argued that the 2015 final rules were too restrictive. Several commenters stated that relying on the medical care component of the CPI-U for purposes of those

rules to account for inflation adjustments to the maximum percentage increase was misguided, and the methodology used to calculate the "premium adjustment percentage" (as defined in 45 CFR 156.130) would be more appropriate because it is tied to the increase in premiums for health insurance and, therefore, better reflects the increase in costs for health coverage. These commenters also noted that relying on the premium adjustment percentage would be consistent with the methodology used to adjust the annual limitation on cost sharing under section 1302(c) of PPACA and section 2707(b) of the PHS Act that applies to non-grandfathered plans. Additionally, one commenter articulated a concern that the 2015 final rules eventually may preclude some grandfathered group health plans or issuers of grandfathered group health insurance coverage from being able to make changes to cost-sharing requirements that are necessary for a plan to maintain its status as an HDHP within the meaning of section 223 of the Code, which would effectively mean that individuals covered by those plans would no longer be eligible to contribute to an HSA.

D. The Premium Adjustment Percentage

Section 1302(c)(4) of PPACA directs the Secretary of HHS to determine an annual premium adjustment percentage, a measure of premium growth that is used to set the rate of increase for three parameters detailed in PPACA: (1) the maximum annual limitation on cost sharing (defined at 45 CFR 156.130(a)); (2) the required contribution percentage used to determine eligibility for certain exemptions under section 5000A of the Code (defined at 45 CFR 155.605(d)(2)); and (3) the employer shared responsibility payment amounts under section 4980H(a) and (b) of the Code (see section 4980H(c)(5) of the Code). Section 1302(c)(4) of PPACA

¹⁰ See 2018 *Employer Health Benefits Survey*, Kaiser Family Foundation, available at <https://www.kff.org/report-section/2018-employer-healthbenefits-survey-section-13-grandfathered-healthplans>. On October 8, 2020, the Kaiser Family Foundation issued its 2020 report. According to survey data, 16 percent of offering firms report having at least one grandfathered plan in 2020, and 14 percent of covered workers were enrolled in a grandfathered health plan in 2020. See 2020 *Employer Health Benefits Survey*, Kaiser Family Foundation, available at <http://files.kff.org/attachment/Report-Employer-Health-Benefits-2020-Annual-Survey.pdf>.

¹¹ "Grandmothered" plans, also known as transitional plans, are certain non-grandfathered health insurance coverage in the small group and individual market that meet certain conditions. On November 14, 2013, CMS issued a letter to the State Insurance Commissioners outlining a policy under which, if permitted by the state, non-grandfathered small group and individual market health plans that were in effect on October 1, 2013, could continue and would not be treated as being out of compliance with certain specified PPACA market reforms under certain conditions. CMS has extended this non-enforcement policy each subsequent year, with the most recent extension in effect until policy years beginning on or before October 1, 2021, provided that all such coverage comes into compliance by January 1, 2022. See *Insurance Standards Bulletin Series – INFORMATION – Extension of Limited Non-Enforcement Policy through 2021* (January 31, 2020), available at <https://www.cms.gov/files/document/extension-limited-non-enforcement-policy-through-calendar-year-2021.pdf>.

and 45 CFR 156.130(e) provide that the premium adjustment percentage is the percentage (if any) by which the average per capita premium for health insurance coverage for the preceding calendar year exceeds such average per capita premium for health insurance for 2013, and 45 CFR 156.130(e) provides that this percentage will be published annually by HHS.

To calculate the premium adjustment percentage for a benefit year, HHS calculates the percentage by which the average per capita premium for health insurance coverage for the preceding calendar year exceeds the average per capita premium for health insurance for 2013 and rounds the resulting percentage to 10 significant digits. The resulting premium index reflects cumulative, historic growth in premiums from 2013 through the preceding year. HHS calculates the premium adjustment percentage using as a premium growth measure the most recently available National Health Expenditure Accounts (NHEA) projection of per enrollee premiums for private health insurance (excluding Medigap and property and casualty insurance) at the time of publication of the premium adjustment percentage.¹²

E. High Deductible Health Plans and HSA-compatibility

Section 223 of the Code permits eligible individuals to establish and contribute to HSAs. HSAs are tax-favored accounts established for the purpose of accumulating funds to pay for qualified medical expenses on behalf of the account beneficiary, his or her spouse, and any claimed dependents. In order for an individual to qualify as an eligible individual under section 223(c)(1) of the Code (and thus to be eligible to make tax-favored contributions to an HSA) the individual must be covered under an HDHP. An HDHP is a health plan that satisfies certain requirements with respect to minimum deductibles and maximum out-of-pocket expenses, which increase annually with cost-of-living adjustments. Generally, ex-

cept for preventive care, an HDHP may not provide benefits for any year until the deductible for that year is met. Pursuant to section 223(g) of the Code, the minimum deductible for an HDHP is adjusted annually for cost of living based on changes in the Chained Consumer Price Index for All Urban Consumers (C-CPI-U).¹³

F. 2020 Proposed Rules

On July 15, 2020, the Departments issued the 2020 proposed rules that would, if finalized, amend the 2015 final rules to provide greater flexibility for grandfathered group health plans and issuers of grandfathered group health insurance coverage to make certain changes without causing a loss of grandfather status. However, there is no authority for non-grandfathered plans to become grandfathered. Therefore, the 2020 proposed rules did not provide any opportunity for a plan or coverage that has lost its grandfather status under the 2015 final rules to regain that status.

In issuing the 2020 proposed rules, the Departments considered comments submitted in response to the 2019 RFI regarding ways that the 2015 final rules could be amended. The Departments did not include in the 2020 proposed rules many suggestions outlined in those comments because, in the Departments' view, those suggestions would have allowed for such significant changes that the modified plan or coverage could not reasonably be described as being the same plan or coverage that existed on March 23, 2010, for purposes of grandfather status. The Departments were persuaded, however, by commenters' statements that there are better means of accounting for inflation in the standard for the maximum percentage increase that should be permitted to fixed-amount cost-sharing requirements. The Departments also agreed that, as one commenter on the 2019 RFI highlighted, there is an opportunity to specify that changes to fixed-amount cost-sharing requirements that are necessary for a plan to maintain its

status as an HDHP should not cause a loss of grandfather status. Given that the 2015 final rules permit increases that are meant to account for inflation in healthcare costs over time, the Departments were of the view that those suggestions were reasonably narrow and consistent with the intent of the 2015 final rules to permit adjustments in response to inflation without causing a loss of grandfather status.

Accordingly, the Departments proposed to amend the 2015 final rules in two ways. First, the 2020 proposed rules included a new paragraph (g)(3), which specified that grandfathered group health plans and grandfathered group health insurance coverage that are HDHPs may make changes to fixed-amount cost-sharing requirements that would otherwise cause a loss of grandfather status without causing a loss of grandfather status, but only to the extent those changes are necessary to comply with the requirements for HDHPs under section 223(c)(2)(A) of the Code. Second, the 2020 proposed rules included a revised definition of "maximum percentage increase" at redesignated paragraph (g) (4), which provided an alternative method of determining that amount based on the premium adjustment percentage. Under the 2020 proposed rules, this alternative method would be available only for grandfathered group health plans and grandfathered group health insurance coverage with changes that are effective on or after the applicability date of a final rule.

The Departments requested comments on all aspects of the 2020 proposed rules, as well as on specific issues related to the 2020 proposed rules where stakeholder feedback would be particularly useful in evaluating whether to issue final rules, and what the content of any final rules should be.

The comment period for the 2020 proposed rules closed on August 14, 2020. The Departments received 13 comments. After careful consideration of these comments, for the reasons explained further in the preamble, the Departments are issuing the final rules, which finalize the 2020 proposed rules without substantive change.

¹² 85 FR 29164, 29228 (May 14, 2020). The series used in the determinations of the adjustment percentages can be found in Table 17 on the CMS web site, which can be accessed by clicking the "NHE Projections 2018-2027 – Tables" link located in the Downloads section at <http://www.cms.gov/Research-Statistics-Data-and-Systems/Statistics-Trends-and-Reports/NationalHealthExpendData/NationalHealthAccountsProjected.html>. A detailed description of the NHE projection methodology is available at <https://www.cms.gov/Research-Statistics-Data-and-Systems/Statistics-Trends-and-Reports/NationalHealthExpendData/Downloads/ProjectionsMethodology.pdf>.

¹³ The Tax Cuts and Jobs Act, Pub. L. 115-97, 131 Stat. 2054 (Dec. 22, 2017), amended section 1(f)(3) of the Code to use the C-CPI-U rather than CPI-U for certain inflation adjustments for tax years beginning after December 31, 2017.

II. Overview of the Final Rules

A. General Response to Public Comments on the 2020 Proposed Rules

Some commenters expressed support for the 2020 proposed rules because the 2020 proposed rules would allow grandfathered group health plans and issuers offering grandfathered group health insurance coverage to make certain key changes without causing a loss of grandfather status. One commenter noted that providing more flexibility to maintain grandfather status should help both plan sponsors and participants. This commenter highlighted that plan sponsors could continue to avoid the costs and burdens associated with compliance with the additional requirements applicable to non-grandfathered plans while plan participants and beneficiaries could retain their current coverage instead of finding alternate coverage and potentially experiencing greater increases in cost sharing or reductions in benefits.

The final rules will allow grandfathered group health plan sponsors and issuers of grandfathered group health insurance coverage more flexibility to make changes to certain types of cost-sharing requirements without causing a loss of grandfather status. The Departments view this flexibility as a way to enable plan sponsors and issuers to continue to offer quality, affordable coverage to their participants and beneficiaries while appropriately taking into account rising healthcare costs. The Departments also are of the view that providing this flexibility will help participants and beneficiaries in grandfathered group health plans maintain their current coverage, including their provider and service network(s). Further, the final rules will provide participants and ben-

eficiaries with the ability to maintain access to affordable coverage options offered by their employers or unions by ensuring that employers and other plan sponsors have the ability to more appropriately account for the rising costs of healthcare due to inflation.

Several commenters did not support the 2020 proposed rules and urged the Departments not to finalize them. These commenters generally stated that finalizing the 2020 proposed rules would allow employers to continue to offer plans that do not provide comprehensive benefits while placing an increased financial burden on participants and beneficiaries. The commenters also noted that grandfathered group health plans lack certain essential patient protections, and that the consequences of not having complete information about grandfathered coverage will be especially detrimental for patients with complex medical conditions. These commenters further asserted that ensuring access to robust coverage and benefits such as preventive services and maternity care is especially important and that, in light of the ongoing COVID-19 pandemic, now is not an appropriate time to allow changes that could shift more costs to consumers.

While the Departments appreciate these concerns, the Departments are of the view that finalizing the 2020 proposed rules strikes a proper balance between preserving plans', issuers', participants', and beneficiaries' ability to maintain existing coverage with the goals of expanding access to and improving the quality of health coverage. The Departments are also of the view that the final rules appropriately support the goal of promoting greater choice in coverage, especially in light of rising healthcare costs. While grandfathered health plans are not required to comply with all PPACA market reform provisions, there are many PPACA

consumer protections that are applicable to all group health plans and issuers offering group health insurance coverage, regardless of grandfather status, including the prohibition on preexisting condition exclusions, the prohibition on waiting periods that exceed 90 days, the prohibition on lifetime or annual dollar limits, the prohibition on rescissions, and the requirement for plans and issuers that offer dependent coverage of children to do so up to age 26. Further, grandfathered group health plans and issuers of grandfathered group health insurance coverage are not prohibited from providing coverage consistent with any of the PPACA market provisions that apply to non-grandfathered group health plans and may add that coverage without relinquishing grandfather status, provided these changes are made without exceeding the standards established by paragraph (g)(1) of the grandfather regulations.

Several commenters urged the Departments to not finalize the 2020 proposed rules due to the ongoing coronavirus disease of 2019 (COVID-19) pandemic. These commenters highlighted that the COVID-19 pandemic has created high levels of economic uncertainty for millions of Americans while also posing risks to their health and safety. The commenters voiced concern that the 2020 proposed rules could have a harmful impact on access to care and affordability during the ongoing COVID-19 pandemic.

As evidenced by the Administration's efforts to address the COVID-19 pandemic, the Departments appreciate that the COVID-19 pandemic has created a greater need for affordable healthcare options for consumers and, accordingly, have taken a number of actions to provide relief and promote increased access to benefits during the COVID-19 pandemic.¹⁴ For

¹⁴ The Departments continue to work with employers and individuals to help them understand the new laws and regulatory relief and to benefit from them, as intended. On April 11, 2020, the Departments issued FAQs Part 42 regarding implementation of the Families First Coronavirus Response Act (FFCRA), and the Coronavirus Aid, Relief, and Economic Security (CARES) Act, and other health coverage issues related to COVID-19 available at: <https://www.dol.gov/sites/dolgov/files/ebsa/about-ebsa/our-activities/resource-center/faqs/aca-part-42.pdf>. In this guidance, the Departments strongly encourage all group health plans and health insurance issuers to promote the use of telehealth and other remote care services. The Departments' guidance also provides enforcement relief that allows plans and issuer to make changes to increase telehealth benefits more quickly than is possible under current law. Specifically, the Departments will not enforce regulations that generally require plans and issuers to provide 60 days' advance notice of certain changes to plan terms and prohibit issuers from making mid-year modifications to health insurance products, with respect to any change that adds benefits or reduces or eliminates cost-sharing requirements for telehealth services and other remote care services. On June 23, 2020, the Departments issued a second round of FAQs, Part 43, providing further guidance regarding requirements of the FFCRA and the CARES Act and related issues available at: <https://www.dol.gov/sites/dolgov/files/ebsa/about-ebsa/our-activities/resource-center/faqs/aca-part-43.pdf>. In light of the critical need to minimize the risk of exposure to and community spread of COVID-19, the FAQs provide a statement of temporary enforcement relief regarding certain requirements that would otherwise apply in order to allow large employers to offer stand-alone telehealth benefits to employees who are not eligible for the employer's primary group health plan. Furthermore, the Departments of Labor and the Treasury published a Joint Notice – Extension of Certain Timeframes for Employee Benefit Plans, Participants, and Beneficiaries (85 FR 26351) on May 4, 2020, <https://www.govinfo.gov/content/pkg/FR-2020-05-04/pdf/2020-09399.pdf>. The Joint Notice extends timeframes for requesting special enrollment in a group health plan, the COBRA election period, and COBRA premium due dates, and certain timeframes relating to benefit claims appeals. On May 14, 2020, HHS published guidance that announced that HHS concurred with the relief specified in the Joint Notice and would adopt a temporary policy of relaxed enforcement to extend similar timeframes otherwise applicable to non-Federal governmental group health plans and health insurance issuers offering coverage in connection with a group health plan, and their participants and beneficiaries, under applicable provisions of title XXVII of the PHS Act, available at <https://www.cms.gov/files/document/Temporary-Relaxed-Enforcement-Of-Group-Market-Timeframes.pdf>.

example, the Departments have published regulatory and subregulatory guidance to assist individuals during the COVID-19 pandemic, including those who have lost their health coverage, and have extended a number of deadlines so that participants and beneficiaries in employee benefit plans have additional time to make critical health coverage decisions affecting their benefits during the COVID-19 pandemic.¹⁵ The Departments highlight that the final rules provide flexibility to employers that currently offer health coverage and have consistently done so since 2010, with the aim that their employees will have a greater ability to maintain that coverage, should they so choose. Accordingly, the Departments are of the view that the flexibility afforded by the final rules is unlikely to exacerbate any difficulties employees may experience in obtaining access to care during the COVID-19 pandemic and will potentially enable employers and employees to maintain more affordable coverage than they may otherwise be able to maintain. Notwithstanding these considerations, the Departments are delaying the applicability of the final rules, to be applicable 6 months after publication in the **Federal Register**, as discussed later in this preamble.

One commenter raised concerns that the continued availability of grandfathered plans might contribute to segmentation of the small-group market, causing adverse selection and, in turn, higher premiums for small businesses that offer or want to offer plans subject to the PPACA market reforms. This commenter noted that, because the non-grandfathered small-group market is subject to modified community rating and a “single risk pool,” firms with younger or healthier-than-average employees have incentives to opt out of the small group market single risk pool, at the expense of other firms that may therefore face higher premiums. Commenters also claimed that the Departments do not have sufficient information and data to accurately predict the financial effect that the

2020 proposed rules would have on consumers.

The Departments acknowledge that the existence of grandfathered group health plans potentially creates market segmentation and adverse selection in the small group market. However, the Departments do not anticipate that the additional flexibilities provided in the final rules will materially increase market segmentation, or adverse selection, as the final rules do not provide a mechanism for non-grandfathered plans to become grandfathered. For this reason, the Departments are of the view that the changes allowed by the final rules will not have a measurable impact on premiums for small businesses that offer or want to offer non-grandfathered group health insurance coverage. Moreover, the Departments do not expect the number of plans that maintain grandfather status because of the final rules to be so significant as to exacerbate any market segmentation that may already exist.

The Departments also received comments stating that consumers risk being confused or having difficulty with the term “grandfathered.” One commenter noted it may be difficult to know whether grandfathered plan participants and beneficiaries are actively choosing to remain in such plans, whether they typically have other non-grandfathered options that they could select, whether they even know a plan is grandfathered, or whether they understand which PPACA consumer protections might be missing when they enroll in grandfathered coverage. Other commenters suggested the addition of greater transparency requirements for employers that offer grandfathered plans as a means to avoid confusion.

The Departments note that these concerns relate to grandfathered plans generally and are not specific to the limited changes made in the proposed or final rules. Under the 2015 final rules, to maintain status as a grandfathered plan, a group health plan or health insurance coverage must include a statement in any

summary of benefits that the plan or coverage believes it is a grandfathered plan. It must also provide contact information for questions and complaints. The 2015 final rules provide model language that the plan or coverage can use to satisfy the disclosure requirement. That language specifically highlights that grandfathered plans are subject to some, but not all, of the PPACA consumer protections that apply to non-grandfathered plans, such as not being subject to the requirement to provide certain preventive health services without cost sharing. This required disclosure of grandfather status is intended to alleviate confusion consumers may face regarding the term “grandfathered” and what benefits and protections are offered under such coverage. The disclosure language is model language, and plans and issuers may include additional disclosure elements, such as the entire list of market reform provisions that do not apply to the specific grandfathered health plan.

Moreover, group health plans, including grandfathered plans, are subject to a number of disclosure requirements under which participants and beneficiaries are entitled to comprehensive information about their benefits. For example, group health plans that are subject to ERISA are required to distribute a summary plan description (SPD) to participants and beneficiaries that provides a comprehensive description of the benefits offered by the plan.¹⁶ In addition, group health plans and issuers of group health insurance coverage, including grandfathered plans, are required to provide a summary of benefits and coverage (SBC) that provides information about benefits and cost sharing in connection with enrollment and renewal.¹⁷ Furthermore, typically, if a plan or issuer makes a material modification to any term that affects the content of the SBC and that is not reflected in the most recently provided SBC, and that occurs other than in connection with a renewal or reissuance of coverage, notice of the change must be

¹⁵ See e.g., Extension of Certain Timeframes for Employee Benefit Plans, Participants, and Beneficiaries Affected by the COVID-19 Outbreak, 85 FR 26351 (May 4, 2020); FAQs About First Coronavirus Response Act and Coronavirus Aid, Relief, and Economic Security Act Implementation Part 42 (April 11, 2020) available at <https://www.dol.gov/sites/dolgov/files/ebsa/about-ebsa/our-activities/resource-center/faqs/aca-part-42.pdf> and <https://www.cms.gov/files/document/FFCRA-Part-42-FAQs.pdf>; FAQs About Families First Coronavirus Response Act and Coronavirus Aid, Relief, and Economic Security Act Implementation Part 43 (June 23, 2020), available at <https://www.dol.gov/sites/dolgov/files/ebsa/about-ebsa/our-activities/resource-center/faqs/aca-part-43.pdf> and <https://www.cms.gov/files/document/FFCRA-Part-43-FAQs.pdf>.

¹⁶ ERISA Section 102.

¹⁷ 26 CFR 54.9815-2715, 29 CFR 2590.715-2715, 45 CFR 147.200.

provided no later than 60 days prior to the date the modification is effective.¹⁸

The Departments have concluded that existing disclosure requirements are sufficient to ensure that participants and beneficiaries have access to relevant information, including information regarding cost sharing, to help them understand the implications of grandfathered coverage. The information included in the model grandfather notice – in particular the language highlighting that certain consumer protections under PPACA do not apply to grandfathered coverage, alongside the information available to individuals in their plan’s SPD and SBC – provides ample disclosure to participants and beneficiaries regarding their benefits to help them decide whether to enroll or remain in such a plan. Therefore, the Departments are declining to include any additional disclosure requirements in the final rules.

a. Special Rule for Certain Grandfathered HDHPs

As explained above, paragraph (g)(1) of the 2015 final rules identifies certain types of changes that will cause a plan or coverage to cease to be a grandfathered health plan, including increases in cost-sharing requirements that exceed certain thresholds. However, cost-sharing requirements for a grandfathered group health plan or group health insurance coverage that is an HDHP must satisfy the minimum annual deductible requirement and maximum out-of-pocket expenses requirement under section 223(c)(2)(A) of the Code in order to remain an HDHP. The Internal Revenue Service updates these amounts annually to reflect a cost-of-living adjustment.

The annual cost-of-living adjustment to the required minimum deductible for an HDHP has not yet exceeded the maximum percentage increase that would cause an HDHP to lose grandfather status.¹⁹ Nevertheless, the Departments are of the view that there is value in specifying that if a

grandfathered group health plan or group health insurance coverage that is an HDHP increases its fixed-amount cost-sharing requirements to meet a future adjusted minimum annual deductible requirement under section 223(c)(2)(A) of the Code that is greater than the increase that would be permitted under paragraph (g)(1) of the 2015 final rules, such an increase would not cause the plan or coverage to relinquish its grandfather status. Otherwise, if such a conflict were to occur, the plan sponsor or issuer would have to decide whether to preserve the plan’s grandfather status or its status as an HDHP, potentially causing participants and beneficiaries to experience either substantial changes to their coverage (and likely premium increases) or a loss of eligibility to contribute to an HSA.

To address this potential conflict, the 2020 proposed rules included a new paragraph (g)(3), which provided that, with respect to a grandfathered group health plan or group health insurance coverage that is an HDHP, increases to fixed-amount cost-sharing requirements that otherwise would cause a loss of grandfather status would not cause the plan or coverage to relinquish its grandfather status, but only to the extent the increases are necessary to maintain its status as an HDHP under section 223(c)(2)(A) of the Code.²⁰ Thus, increases with respect to such a plan or coverage that would otherwise cause a loss of grandfather status and that exceed the amount necessary to satisfy the minimum annual deductible requirement under section 223(c)(2)(A) of the Code would still cause a loss of grandfather status. The 2020 proposed rules also added a new example 11 under paragraph (g)(5) to illustrate how this special rule would apply.

Several commenters supported the 2020 proposed rules to allow a grandfathered HDHP to make changes to fixed-amount cost-sharing requirements without causing a loss of grandfather status to the extent the increases are necessary

to maintain the plan’s status as an HDHP. One commenter highlighted that without this regulatory change, HDHPs could be forced out of their grandfather status if the annual cost-of-living adjustment to the required minimum deductible for an HDHP exceeds the maximum percentage increase allowed under the 2015 final rules. Another commenter articulated that without this provision, participants and beneficiaries who are covered under a grandfathered HDHP and eligible to contribute to an HSA may lose their eligibility to contribute to an HSA if their plan chooses to relinquish its HDHP status to maintain its grandfather status. The commenter also raised the concern of facing substantial premium increases as a result of having to choose other health coverage in the event of an HDHP failing to maintain its HDHP status.

The Departments agree that the special rule for grandfathered HDHPs could help participants and beneficiaries enrolled in these plans. The Departments are of the view that there is value in specifying that grandfathered HDHPs will not be forced to choose whether to preserve their grandfather status or their status as an HDHP and that they can continue to provide the coverage with which their participants and beneficiaries are familiar and comfortable. The Departments also agree that this special rule will help ensure that plans are able to comply with minimum cost-sharing requirements for HDHPs so participants and beneficiaries covered under HDHPs can continue to be eligible to contribute to HSAs. In adopting the final rules, the Departments specifically intend to ensure that participants and beneficiaries enrolled in HDHPs with grandfather status are able to maintain their eligibility to contribute to HSAs.

Other commenters expressed concerns that allowing grandfathered HDHPs to preserve both their grandfather status and HDHP status by implementing fixed dollar cost-sharing increases that exceed

¹⁸ 26 CFR 54.9815-2715(b), 29 CFR 2590.715-2715(b), 45 CFR 147.200(b).

¹⁹ For calendar year 2020, a “high deductible health plan” is defined under Code section 223(c)(2)(A) as a health plan with an annual deductible that is not less than \$1,400 for self-only coverage or \$2,800 for family coverage, and the annual out-of-pocket expenses (deductibles, co-payments, and other amounts, but not premiums) for which do not exceed \$6,900 for self-only coverage or \$13,800 for family coverage. Rev. Proc. 2019-25 (2019-22 I.R.B. 1261). For calendar year 2021, a “high deductible health plan” is defined under Code section 223(c)(2)(A) as a health plan with an annual deductible that is not less than \$1,400 for self-only coverage or \$2,800 for family coverage, and the annual out-of-pocket expenses (deductibles, co-payments, and other amounts, but not premiums) for which do not exceed \$7,000 for self-only coverage or \$14,000 for family coverage. Rev. Proc. 2020-32 (2020-24 I.R.B. 930).

²⁰ Paragraph (g)(3) of the 2015 final rules would be renumbered as paragraph (g)(4), and subsequent paragraphs would be renumbered accordingly. Additionally, the 2020 proposed rules included conforming amendments to other paragraphs to update all cross-references to those subparagraphs.

the standards established under the 2015 final rules might result in increased costs for consumers enrolled in HDHPs. These commenters stated that the proposed changes would further exacerbate existing affordability issues, in particular by raising deductibles to potentially unaffordable levels and subjecting consumers to increased cost sharing. Several commenters noted that increased cost sharing for HDHPs may discourage consumers from seeking medical care or cause consumers to forego treatment if the necessary services became unaffordable. Moreover, commenters noted that high out-of-pocket costs for medical care related to the diagnosis and/or treatment of COVID-19 may deter individuals from seeking care, potentially contributing to increased transmission of COVID-19.

The Departments acknowledge commenters' concerns related to potential increased cost and affordability issues, but the Departments do not anticipate significant cost increases for consumers enrolled in grandfathered HDHPs. In addition, this special rule is narrowly tailored, as it permits flexibility only to the extent necessary to maintain a plan's status as an HDHP under section 223(c)(2)(A) of the Code. Without this regulatory change, grandfathered HDHPs could be forced to choose between maintaining grandfather status and remaining HDHPs. The flexibility offered by the special rule for grandfathered HDHPs will benefit participants and beneficiaries covered under these plans as it balances potential affordability issues with safeguards. Specifically, the final rules allow plan sponsors to continue offering grandfathered coverage, thereby enabling participants and beneficiaries to maintain existing coverage, while only permitting plan sponsors to make certain cost-sharing increases to the extent necessary to maintain HDHP status. Moreover, the Departments expect that the impact of the special rule will be modest: sponsors of grandfathered HDHPs will have greater

flexibility to continue offering their plans as grandfathered, protecting those enrolled in these plans from the disruption and potentially increased out-of-pocket costs associated with changing to a different plan or coverage that may not be an HDHP or grandfathered. This consideration carries particular weight because of the COVID-19 pandemic, during which losing access to a plan or coverage, potentially including losing access to a specific provider network, could be particularly disruptive.

b. Definition of Maximum Percentage Increase

Under the 2015 final rules, medical inflation means the increase since March 2010 in the overall medical care component of the CPI-U published by the DOL using the 1982-1984 base of 100. The medical care component of the CPI-U is a measure of the average change over time in the prices paid by urban consumers for medical care. Although the Departments continue to be of the view that this is an appropriate measure for medical inflation in this context, the Departments recognize that the medical care component of CPI-U reflects not only changes in price for private insurance, but also for self-pay patients and Medicare, neither of which are reflected in the underlying costs for grandfathered group health plans and grandfathered group health insurance coverage. In contrast, the premium adjustment percentage reflects the cumulative, historic growth from 2013 through the preceding calendar year in premiums for only private health insurance, excluding Medigap and property and casualty insurance. Therefore, the Departments agreed with comments received in response to the 2019 RFI that the premium adjustment percentage may better reflect the increase in underlying costs for grandfathered group health plans and grandfathered group health insurance coverage.²¹

Accordingly, the 2020 proposed rules included an amended definition of the maximum percentage increase with an alternative standard that relies on the premium adjustment percentage, rather than medical inflation (which continues to be defined, for purposes of these rules, as the overall medical care component of the CPI-U, unadjusted), to account for changes in healthcare costs over time. Under the 2020 proposed rules, this alternative standard would not supplant the current standard; rather, it would be available to the extent it yields a higher-dollar value than the current standard, and it would apply only with respect to increases in fixed-amount cost-sharing requirements that are made effective on or after the applicability date of the final rules. With respect to increases for group health plans and group health insurance coverage made effective on or after March 23, 2010, but before the applicability date of the final rules, the maximum percentage increase would still be defined as medical inflation expressed as a percentage, plus 15 percentage points.²²

Thus, under the 2020 proposed rules, increases to fixed-amount cost-sharing requirements for grandfathered group health plans and grandfathered group health insurance coverage that are made applicable on or after the applicability date of the final rules would cause the plan or coverage to cease to be a grandfathered health plan if the total percentage increase in the cost-sharing requirement measured from March 23, 2010 exceeds the greater of (1) medical inflation, expressed as a percentage, plus 15 percentage points; or (2) the portion of the premium adjustment percentage, as defined in 45 CFR 156.130(e), that reflects the relative change between 2013 and the calendar year prior to the effective date of the increase (that is, the premium adjustment percentage minus 1), expressed as a percentage, plus 15 percentage points.²³ The 2020 proposed rules also added a new example 5 under para-

²¹ The Departments acknowledge that the premium adjustment percentage does not capture premium growth from 2010 to 2013, and that it reflects increases in premiums not only in the group market, but also in the individual market, which have increased more rapidly than premiums for group health plans and group health insurance. However, the Departments have concluded that the premium adjustment percentage may be the best alternative existing measure to reflect the increase in underlying costs for grandfathered group health plans and grandfathered group health insurance coverage. Additionally, the Departments are of the view that using a measure with which plans and issuers are already familiar will promote administrative simplicity.

²² The amendments included in the 2020 proposed rules would apply only with respect to grandfathered group health plans and grandfathered group health insurance coverage. Because HHS regulations at 45 CFR 147.140 apply to both grandfathered individual and group health coverage, the amended definition of the maximum percentage increase in the HHS proposed rules would also add a separate provision for individual health insurance coverage to make clear that the definition applicable to individual coverage remains unchanged.

²³ Stakeholders should look to official publications from the Bureau of Labor Statistics and HHS to identify the relevant overall medical care component of the CPI-U amount or premium adjustment percentage with respect to a change being considered by a grandfathered health plan.

graph (g)(5) to demonstrate how this alternative measure for determining the maximum percentage increase might apply in practice. Similar to other examples in paragraph (g)(5), the proposed new example 5 included hypothetical numbers with respect to both the overall medical care component of the CPI-U and the premium adjustment percentage that do not relate to any specific time period and are used for illustrative purposes only. The 2020 proposed rules also renumbered examples 5 through 9 in paragraph (g)(5) to allow the inclusion of new example 5 and revised examples 3 through 6 to clarify that these examples involve plan changes that became effective before the applicability date of these final rules. These proposed revisions would ensure that the examples accurately reflect the other provisions of the 2015 final rules.

In support of this provision in the 2020 proposed rules, one commenter pointed out that the ability to use a premium adjustment percentage for permitted changes in fixed cost-sharing amounts would be helpful to multiemployer plan sponsors wishing to maintain grandfather status. Another commenter said that the premium adjustment percentage is an amount very familiar to group health plan sponsors, and it is based on factors related to group plan premiums, making it a natural complement to the grandfathered plan cost-sharing requirements.

Some commenters stated that the 2020 proposed rules should have provided even greater flexibility. One commenter suggested that instead of examining changes to healthcare costs over cumulative years since March 23, 2010, the Departments should consider allowing a set percentage of allowable increase annually. Another commenter urged the Departments to make additional changes in the final rules to provide more flexibility, allowing plan design changes specifically to encourage cost-effective quality care, such as greater ability to change cost sharing for brand drugs and out-of-network benefits.

One commenter stated that the Departments' intent to allow grandfathered plans to increase out-of-pocket costs at a rate that is the greater of the medical inflation adjustment or the premium adjustment percentage adjustment (plus 15 percentage points) would, by design, result in

increased out-of-pocket costs for participants and beneficiaries. This commenter stated that using the premium adjustment percentage for this calculation would leave patients vulnerable to financial hardship. Another commenter asserted that the proposed amendment to the definition of maximum percentage increase would likely result in increased cost sharing, and in turn, less favorable coverage for individuals enrolled in grandfathered coverage, to the detriment of many consumers who rely on employment-based health coverage and who may not have an option to enroll in coverage that complies with the generally applicable market reforms made by PPACA.

As stated earlier in this preamble, the Departments have concluded that the proposed and final rules strike the right balance between allowing grandfathered health plans the flexibility to design their health plans to meet their changing needs and ensuring that affordable healthcare options for participants and beneficiaries remain available. The Departments are unpersuaded that the final rules will result in significant financial hardship due to the additional permitted increases in out-of-pocket costs for participants and beneficiaries. As noted earlier in this preamble, providing an alternative inflation adjustment for fixed-amount cost-sharing increases will help plans and issuers better account for changes in the costs of health coverage over time, potentially allowing them to maintain the grandfathered coverage for those participants and beneficiaries. Therefore, the Departments are of the view that allowing plans and issuers to use this measure is appropriate and it may capture changes in healthcare costs at least as accurately as the medical inflation standard. Accordingly, the Departments are finalizing this change, as proposed.

III. Effective Date

In the 2020 proposed rules, the Departments proposed an effective date of 30 days after publication of the final rules. The Departments are finalizing as proposed an effective date of 30 days after publication of the final rules, which would be January 14, 2021. However, in response to comments, the Departments are including an applicability date which will

make the final rules applicable to grandfathered group health plans and grandfathered group health insurance coverage beginning on June 15, 2021. While the Departments did not receive any comments specifically requesting that the applicability date of the final rules be delayed to 6 months after publication, the Departments did receive a number of comments related to the COVID-19 pandemic and the timing of the final rules, as discussed earlier in this preamble. Commenters expressed concern that it is not appropriate to potentially place a greater financial burden related to healthcare on patients while the COVID-19 pandemic is ongoing.

As explained above, in the Departments' view, the final rules will allow employers to continue to offer affordable coverage to those who are eligible for grandfathered employer-sponsored plans. However, the Departments acknowledge commenters' reasonable concerns regarding the timing of the final rules and the uncertainty created by the COVID-19 pandemic. The Departments are therefore delaying the applicability date of the final rules to 6 months after publication in the Federal Register. The Departments are of the view that this delay is appropriate, as the Departments do not expect the delay to have a significant short-term impact on plans' and issuers' ability to make use of the cost-sharing flexibilities afforded under the final rules; instead, a short delay will reduce uncertainty by allowing plans, issuers, and those covered by grandfathered plans more time to understand and plan for the increased flexibility provided by the final rules.

IV. Economic Impact Analysis and Paperwork Burden

A. Summary/Statement of Need

Section 1251 of PPACA generally provides that certain group health plans and health insurance coverage existing on March 23, 2010, are not subject to certain provisions of PPACA as long as they maintain grandfather status. On February 25, 2019, the Departments published an RFI to gather information on grandfathered group health plans and grandfathered group health insurance coverage. Comments received from stakeholders in

response to the 2019 RFI suggested that issuers and plan sponsors, as well as participants and beneficiaries, continue to value grandfathered group health plan and grandfathered group health insurance coverage. The Departments issued a notice of proposed rulemaking on July 15, 2020, to amend the 2015 final rules to provide greater flexibility for certain grandfathered health plans to make changes to certain types of cost-sharing requirements without causing a loss of grandfather status. The Departments are of the view that these final rules are appropriate to provide certain grandfathered health plans greater flexibility while appropriately taking into account rising healthcare costs. Additionally, the final rules will ensure that grandfathered plans are able to make changes to comply with minimum cost-sharing requirements for HDHPs without losing grandfather status, so enrolled individuals continue to be eligible to contribute to HSAs. These changes will allow certain grandfathered group health plans and grandfathered group health insurance coverage to continue to be exempt from certain provisions of PPACA and allow those plans' participants and beneficiaries to maintain their current coverage.

In drafting the final rules, the Departments attempted to balance a number of competing interests. The Departments sought to balance providing greater flexibility to grandfathered group health plans and grandfathered group health insurance coverage that will enable these plans and coverage to continue offering quality, affordable coverage to participants and beneficiaries while ensuring that the final rules will not allow for such significant changes that the plan or coverage could not reasonably be described as being the same plan or coverage that was offered on March 23, 2010. Additionally, the Departments sought to allow grandfathered group health plans and grandfathered group health insurance coverage to better account for rising healthcare costs, including ensuring that grandfathered group HDHPs are able to maintain their grandfather status, while continuing to comply with minimum cost-sharing requirements for HDHPs, so that the individuals enrolled in the HDHPs are eligible to contribute to an HSA. In

previous rulemaking, the Departments recognized that many group health plans and issuers make changes to the terms of plans or health insurance coverage on an annual basis: premiums fluctuate, provider networks and drug formularies change, employer and employee contributions and cost-sharing requirements change, and covered items and services may vary. Without some flexibility to make adjustments while retaining grandfather status, the ability of many individuals to maintain their current coverage would be frustrated, because much of the grandfathered group health plan coverage would quickly cease to be regarded as the same health plan or health insurance coverage in existence on March 23, 2010. At the same time, allowing grandfathered health plans and grandfathered group health insurance coverage to make unfettered changes while retaining grandfather status would be inconsistent with Congress's intent in enacting PPACA.²⁴

The final rules amend the 2015 final rules to provide greater flexibility for grandfathered group health plans and issuers of grandfathered group health insurance coverage in two ways. First, the final rules specify that any grandfathered group health plan and grandfathered group health insurance coverage that is an HDHP may make changes to fixed-amount cost-sharing requirements that would otherwise cause a loss of grandfather status without causing a loss of grandfather status, but only to the extent those changes are necessary to comply with the requirements for HDHPs under section 223(c)(2) (A) of the Code. Second, the final rules include a revised definition of maximum percentage increase, which provides an alternative standard that relies on the premium adjustment percentage, rather than medical inflation, to account for changes in healthcare costs over time, providing for an alternative inflation adjustment for fixed-amount cost-sharing increases.

B. Overall Impact

The Departments have examined the impacts of the final rules as required by Executive Order 12866 on Regulatory Planning and Review (September 30, 1993),

Executive Order 13563 on Improving Regulation and Regulatory Review (January 18, 2011), the Regulatory Flexibility Act (RFA) (September 19, 1980, Pub. L. 96-354), section 1102(b) of the Social Security Act (SSA), section 202 of the Unfunded Mandates Reform Act of 1995 (March 22, 1995, Pub. L. 104-4), Executive Order 13132 on Federalism (August 4, 1999), the Congressional Review Act (5 U.S.C. 804(2)), and Executive Order 13771 on Reducing Regulation and Controlling Regulatory Costs (January 30, 2017).

Executive Orders 12866 and 13563 direct agencies to assess all 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. A regulatory impact analysis (RIA) must be prepared for rules with economically significant effects (\$100 million or more in any 1 year).

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

An RIA must be prepared for major rules with economically significant effects (\$100 million or more in any one year), and a "significant" regulatory action is

²⁴ 75 FR 34538, 34546 (June 17, 2010).

subject to Office of Management and Budget (OMB) review. The final rules are not likely to have economic impacts of \$100 million or more in any 1 year, and therefore do not meet the definition of “economically significant” within the meaning of section 3(f)(1) of Executive Order 12866. However, OMB has determined that the actions are significant within the meaning of section 3(f)(4) of the Executive Order. Therefore, OMB has reviewed the final rules, and the Departments have provided the following assessment of their impact.

Some commenters stated that the rules should not be finalized because the Departments had insufficient information and data to estimate the effects of the 2020 proposed rules on grandfathered group health plans and coverage as well as those enrolled in such coverage. The Departments acknowledge that, given the lack of information and data, the Departments are not able to precisely estimate the overall impact of the final rules. As discussed later in the impact analysis, the Departments note the inability to predict what changes each grandfathered group health plan will make in response to the final rules. The Departments recognize that some grandfathered group health plans may take advantage of flexibilities provided by the final rules to change certain types of cost-sharing requirements in amounts greater than the current rules

allow, potentially increasing out-of-pocket costs at a higher rate for some participants and beneficiaries, while potentially reducing premiums for others. However, other grandfathered group health plans may make relatively minor, or no, changes. As discussed previously in this preamble, the Departments note that the fact that a significant number of grandfathered group health plans and coverage remain indicates that some employers and issuers have found value in preserving grandfather status. The Departments are of the view that preserving grandfather status will enable participants to retain their current coverage, including their provider network(s), maintain access to affordable coverage options, and ensure that employers and other grandfathered group health plan sponsors can more appropriately account for the rising costs of healthcare due to inflation. The Departments have also concluded that the final rules appropriately support the goal of promoting greater choices in coverage, especially in light of rising healthcare costs.

C. Impact Estimates of Grandfathered Group Health Plans and Grandfathered Group Health Insurance Coverage Provisions and Accounting Table

The final rules amend the 2015 final rules to provide greater flexibility for grandfathered group health plan sponsors

and issuers of grandfathered group health insurance coverage to make certain changes to cost-sharing requirements without causing a loss of grandfather status. The final rules specify that issuers or sponsors of any grandfathered group health plan and grandfathered group health insurance coverage that is an HDHP may make changes to fixed-amount cost-sharing requirements that would otherwise cause a loss of grandfather status without causing a loss of grandfather status, but only to the extent those changes are necessary to comply with the requirements for HDHPs under section 223(c)(2)(A) of the Code. The final rules also revise the definition of maximum percentage increase to provide an alternative standard that relies on the premium adjustment percentage, rather than medical inflation, to account for changes in healthcare costs over time. In accordance with OMB Circular A-4, Table 1 depicts an accounting statement summarizing the Departments’ assessment of the benefits, costs, and transfers associated with this regulatory action.

The Departments are unable to quantify all benefits, costs, and transfers of the final rules. The effects in Table 1 reflect non-quantified impacts and estimated direct monetary costs and transfers resulting from the provisions of the final rules for grandfathered group health plans, issuers of grandfathered group health coverage, participants, and beneficiaries.

TABLE 1: Accounting Table

| | | | | |
|--|------------------|-------------|---------------|----------------|
| Benefits | | | | |
| Non-Quantified: | | | | |
| <ul style="list-style-type: none"> Increases flexibility for plan sponsors and issuers of grandfathered group health plans and grandfathered group health insurance coverage to make changes to certain fixed-amount cost-sharing requirements without losing grandfather status. If there is uptake of this flexibility: <ul style="list-style-type: none"> Allows participants and beneficiaries in grandfathered group health plans and grandfathered group health insurance coverage to maintain coverage they are familiar with and potentially provides continuity of care by not requiring them to change their health plan to one that may not include their current provider(s). Ensures plan sponsors are able to comply with minimum cost-sharing requirements for HDHPs and allows participants and beneficiaries to maintain their coverage and eligibility to contribute to an HSA. Decreases the likelihood that plan sponsors would cease offering health benefits due to a lack of flexibility to make changes to certain fixed cost-sharing amounts without losing grandfather status. Potential reduction in adverse health outcomes if there is a decrease in the uninsured rate if participants and beneficiaries choose to obtain coverage due to potential premium reductions for grandfathered group health plans and grandfathered group health insurance coverage and seek needed healthcare. | | | | |
| Costs | Primary Estimate | Year Dollar | Discount Rate | Period Covered |
| Annualized Monetized (\$/year) | \$6.09 million | 2020 | 7 percent | 2021-2025 |
| | \$5.67 million | 2020 | 3 percent | 2021-2025 |

| |
|---|
| Quantitative: |
| <ul style="list-style-type: none"> Regulatory review costs of \$26.73 million, incurred in 2021, by grandfathered group health plan coverage sponsors and issuers. |
| Non-Quantified: |
| <ul style="list-style-type: none"> Potential increase in adverse health outcomes if a participant or beneficiary foregoes treatment because the necessary services became unaffordable due to an increase in cost-sharing. Potential increase in adverse health outcomes if there is an increase in the uninsured rate if participants and beneficiaries choose to cancel their coverage or decline to enroll because of the increases in cost-sharing requirements associated with grandfathered group health plans and grandfathered group health insurance coverage. If an employer would have otherwise switched to a non-grandfathered plan, potential increase in adverse health outcomes if a participant or beneficiary foregoes treatment for medical conditions that are not covered by their grandfathered group health plan and grandfathered group health insurance coverage, but that would have been covered by non-grandfathered health plan coverage subject to all PPACA market reforms. |
| Transfers |
| Non-Quantified: |
| <ul style="list-style-type: none"> For grandfathered group health plans and grandfathered group health insurance coverage that utilize the expanded flexibilities to increase fixed-amount cost-sharing requirements, potential transfers occur from participants and beneficiaries with resulting higher out-of-pocket costs to participants and beneficiaries with no or low out-of-pocket costs and nonparticipants through potentially lower premiums and correspondingly smaller wage adjustments to pay for the premiums. If an employer would have otherwise switched to a non-grandfathered plan with expanded benefits, potential transfers occur from participants and beneficiaries who would have benefited from these expanded benefits to others in the plan who would not have benefited from these expanded benefits through lower premiums and correspondingly smaller wage adjustments. |

Table 1 provides the anticipated benefits, costs, and transfers (quantitative and non-quantified) to sponsors and issuers of grandfathered health plan coverage, participants and beneficiaries enrolled in grandfathered plans, as well as nonparticipants. The following section describes the benefits, costs, and transfers to grandfathered group health plan sponsors, issuers of grandfathered group health insurance coverage, and those individuals enrolled in such plans.

Economic Impacts of Retaining or Relinquishing Grandfather Status and Affected Entities and Individuals

The Departments estimate that there are 2.5 million ERISA-covered plans offered by private employers that cover an estimated 136.2 million participants and beneficiaries in those private employer-sponsored plans.²⁵ Similarly, the De-

partments estimate that there are 84,087 state and local governments that offer health coverage to their employees, with an estimated 32.8 million participants and beneficiaries in those employer-sponsored plans.²⁶

The Kaiser Family Foundation 2020 Employer Health Benefits Survey reports that 16 percent of firms offering health benefits have at least one health plan or benefit package option that is a grandfathered plan, and 14 percent of covered workers are enrolled in grandfathered plans.²⁷ Using this information, the Departments estimate that, of those firms offering health benefits, 400,000 sponsor ERISA-covered plans (2.5 million * 0.16) that are grandfathered (or include a grandfathered benefit package option) and cover 19.1 million participants and beneficiaries (136.2 million * 0.14). The Departments further estimate there are 13,454 state and local governments (84,087 * 0.16) offer-

ing at least one grandfathered health plan and 4.6 million participants and beneficiaries (32.8 million * 0.14) covered by a grandfathered state or local government plan.

Although the Kaiser Family Foundation 2020 Employer Health Benefits Survey reports that 20 percent of firms offering health benefits offered an HDHP and 24 percent of covered workers were enrolled in HDHPs, the Departments are of the view that the 2010 Employer Health Benefits Survey provides a better estimate of the prevalence of HDHPs in the grandfathered group market as it provides an estimate for the number of potential HDHPs that would have been able to obtain and maintain grandfather status. The 2010 Employer Health Benefits Survey reported that 12 percent of firms offering health benefits offered an HDHP, and 6 percent of covered workers were enrolled in HDHPs.²⁸

²⁵ U.S. Department of Labor, EBSA calculations using the 2019 Medical Expenditure Panel Survey, Insurance Component (MEPS-IC), the Form 5500 and 2017 Census County Business Patterns; Health Insurance Coverage Bulletin: Abstract of Auxiliary Data for the March 2019 Annual Social and Economic Supplement to the Current Population Survey, Table 3C (forthcoming).

²⁶ 2017 Census of Governments, Government Organization Report, available at <https://www.census.gov/data/tables/2017/econ/gus/2017-governments.html>; 2017 MEPS-IC State and Local Government data, available for query at https://meps.ahrq.gov/mepsweb/data_stats/MEPSnetIC/startup; Health Insurance Coverage Bulletin: Abstract of Auxiliary Data for the March 2019 Annual Social and Economic Supplement to the Current Population Survey, Table 3C, (forthcoming).

²⁷ The Departments note that comments received in response to the 2019 RFI and summarized earlier in this preamble described data obtained from Kaiser Family Foundation 2018 Employer Health Benefits Survey. See *supra* note 9. For the purposes of this RIA, the Departments used more recent data from the same survey. See Kaiser Family Foundation, “2020 Employer Health Benefits Survey,” available at <https://www.kff.org/health-costs/report/2020-employer-health-benefits-survey/>.

²⁸ Kaiser Family Foundation, “2010 Employer Health Benefits Survey,” (Sept. 2010), available at: <https://www.kff.org/wp-content/uploads/2013/04/8085.pdf>.

Benefits

The Departments are of the view that the economic effects of the final rules will ultimately depend on decisions made by grandfathered plan sponsors (including sponsors of grandfathered HDHPs) and the preferences of plan participants and beneficiaries. To determine the value of retaining a health plan's grandfather status, each group plan sponsor must determine whether the plan, under the rules applicable to grandfathered health plan coverage, will continue to be more or less favorable than the plan as it would exist under the rules applicable to non-grandfathered group health plans. This determination will depend on such factors as the respective prices of grandfathered group health plan and non-grandfathered group health plans, the willingness of grandfathered group health plans' covered populations to pay for benefits and protections available under non-grandfathered group health plans, and the participants' and beneficiaries' willingness to accept any increases in out-of-pocket costs due to changes to certain types of cost-sharing requirements. The Departments have concluded that providing flexibilities to make changes to certain types of cost-sharing requirements in grandfathered group health plans and grandfathered group health insurance coverage without causing a loss of grandfather status will enable plan sponsors and issuers to continue to offer quality, affordable coverage to their participants and beneficiaries while taking into account rising healthcare costs.

The Departments anticipate that the premium adjustment percentage index will continue to experience faster growth than medical CPI-U, and therefore are of the view that providing the alternative method of determining the maximum percentage increase will, over time, give grandfathered group health plans and grandfathered group health insurance coverage the flexibility to make changes to the plans' fixed-amount cost-sharing requirements (such as copayments, deductibles, and out-of-pocket limits) that would have previously resulted in the loss of grand-

father status. Thus, the Departments are of the view that the final rules will allow sponsors of those grandfathered group health plans and coverage to continue to provide the coverage with which their participants and beneficiaries are familiar and comfortable, without the unnecessary burden of finding other coverage. Additionally, if the flexibilities provided for in the final rules result in a reduction in grandfathered group health plan and grandfathered group health insurance coverage premiums, there could potentially be a reduction in adverse health outcomes if participants and beneficiaries chose to obtain coverage they may have previously foregone and seek needed healthcare.²⁹

As noted previously in this preamble, in response to the 2019 RFI, some commenters suggested that their grandfathered plans offer more robust provider networks than other coverage options available to them or that they want to ensure that participants and beneficiaries are able to keep receiving care from current in-network providers. The Departments are of the view that providing the flexibilities in the final rules will help participants and beneficiaries maintain their current provider and service networks. If providers continue participating in the grandfathered plans' networks, this continuity offers participants and beneficiaries the ability to continue current and future care through those providers with whom they have built relationships.

As discussed previously in this preamble, one commenter on the 2019 RFI articulated a concern that the 2015 final rules may eventually preclude some sponsors and issuers of grandfathered group health plans and grandfathered group health insurance coverage from being able to make changes to fixed-amount cost-sharing requirements necessary to maintain a plan's HDHP status. For participants and beneficiaries, this would mean they could experience either substantial changes to their coverage (and likely premium increases) or a loss of eligibility to contribute to an HSA. The Departments expect that, under the 2015 final rules, there may be limited circumstances in which a grandfa-

thered group health plan or grandfathered group health insurance coverage that is an HDHP (grandfathered HDHP) is unable to simultaneously maintain its grandfather status and satisfy the requirements for HDHPs under section 223(c)(2)(A) of the Code. Nonetheless, to avoid this scenario and provide assurance to grandfathered group health plan sponsors and issuers of grandfathered HDHPs, the final rules allow a grandfathered HDHP to make changes to fixed-amount cost-sharing requirements that otherwise could cause a loss of grandfather status without causing a loss of grandfather status, but only to the extent the increases are necessary to comply with the requirements for HDHPs under section 223(c)(2)(A) of the Code.

The Departments have concluded that providing this flexibility to grandfathered HDHPs will allow them to preserve their grandfather status even if they increase their cost-sharing requirements to meet a future adjusted minimum annual deductible requirement under section 223(c)(2)(A) of the Code beyond the increase that would be permitted under paragraph (g)(1) of the 2015 final rules. Under section 223(g) of the Code, the required minimum deductible for an HDHP is adjusted for cost-of-living based on changes in the overall economy. Historically, the allowed increases under the 2015 final rules, which are based on changes in medical care costs (medical CPI-U), have exceeded increases based on changes in the overall economy (CPI-U or, for tax years beginning after December 31, 2017, C-CPI-U). Using 10 years of projections from the President's FY 2021 Budget, medical-CPI-U is expected to grow faster than CPI-U. Further, because the allowed increases under the 2015 final rules are based on the cumulative effect over a period of years, it is unlikely that using medical-CPI-U to index deductibles would result in lower deductibles than using C-CPI-U as required under section 223(g) of the Code.³⁰ Therefore, the Departments note that, to the extent these trends continue, it is unlikely that an increase required under section 223 of the Code for a plan to remain an HDHP would exceed the allowed increas-

²⁹ To the extent that utilization and health expenditures are relatively stable, the Departments expect that higher cost sharing may lead to lower premiums, both because higher cost sharing will reduce issuers' share of the costs of care and because of medical loss ratio (MLR) requirements, which encourage issuers to pass these savings to consumers in the form of lower premiums.

³⁰ As noted earlier in this preamble, the Tax Cuts and Jobs Act amended section 1(f)(3) of the Code, cross-referenced in section 223(g) of the Code, to refer to C-CPI-U, instead of CPI-U, for tax years beginning after December 31, 2017.

es under the 2015 final rules. Furthermore, to the extent that the revised definition of maximum percentage increase in the final rules will allow the deductible to grow as fast, or faster, than under the 2015 final rules, grandfathered HDHPs may not need to avail themselves of the additional flexibility provided in the final rules. Nevertheless, the Departments are of the view that affording this flexibility will make the rules more transparent to sponsors of grandfathered HDHPs. Thus, the final regulations will allow participants and beneficiaries enrolled in those plans to maintain their current coverage, continue contributing to any existing HSA, and potentially realize any reduction in premiums that may result from changes in cost-sharing requirements.

Costs and Transfers

The Departments recognize there are costs associated with the final rules that are difficult to quantify given the lack of information and data. For example, the Departments do not have data related to the current annual out-of-pocket costs for participants and beneficiaries in grandfathered group HDHPs or other grandfathered group health plans and grandfathered group health insurance coverage. The Departments recognize that as medical care costs increase, some participants and beneficiaries in grandfathered health plans could face higher out-of-pocket costs for services that may be excluded by such plans, but that would be required to be covered by non-grandfathered group health plans and group health insurance coverage subject to PPACA market reforms. As noted earlier in this analysis, it is possible that lower premiums, compared to the likely premiums if these rules are not finalized, could partially offset these increased costs. Further, participants and beneficiaries who would otherwise be covered by a non-grandfathered plan could potentially face increases in adverse

health outcomes if they forego treatment because certain services are not covered by their grandfathered plan or coverage. The Departments cannot precisely predict the number of group health plans and group health insurance coverage that will retain their grandfather status as a result of the final rules. According to the annual Kaiser Family Foundation Employer Health Benefits Survey, the percentage of employers offering health coverage that offered at least one grandfathered plan between 2016 and 2019 has been relatively stable (23 percent in 2016 to 22 percent in 2019).³¹ The Departments are of the view that a large change over that time period would have indicated that the 2015 final rules were too restrictive and that a relaxation of those rules would have a large effect. The actual small change suggests the opposite. Therefore, the Departments do not expect a significant impact on the number of grandfathered group health plans or grandfathered group health insurance coverage as a result of the final rules.

For those plans and coverages that continue to maintain their grandfather status as a result of the flexibilities in the final rules, the participants and beneficiaries will continue to have coverage and may experience lower premiums when compared to non-grandfathered group health plans. Although some participants and beneficiaries will pay higher cost-sharing amounts, these increased costs may be partially offset by reduced employee premiums, and indirectly through potential wage adjustments that reflect reduced employer contributions due to any resulting lower premiums. In contrast, individuals who have low or no medical expenses, along with nonparticipants, will be unlikely to experience increased cost-sharing amounts and may benefit from lower employee premiums, and indirectly through potential wage adjustments.

The Departments recognize there will be transfers associated with the final rules that are difficult to quantify given the

lack of information and data. The Departments realize that if plan sponsors avail themselves of the flexibilities in the final rules, some participants and beneficiaries of grandfathered group health plans and grandfathered group health insurance coverage will potentially see increases in out-of-pocket costs depending on the changes made to their plans. Additionally, participants and beneficiaries in a grandfathered HDHP could face increases in the plan's deductible if plans increase their fixed-amount cost-sharing requirements to meet a future adjusted minimum annual deductible requirement beyond the increase that is permitted under the 2015 final rules. Changes in costs associated with increased deductibles or other cost sharing will be a transfer from participants and beneficiaries with higher out-of-pocket costs to participants and beneficiaries with lower or no out-of-pocket costs and to nonparticipants, as the related premium reductions could affect wages.

Due to the overall lack of information and data related to what grandfathered group plan sponsors will choose to do, the Departments are unable to precisely estimate the overall economic impact, but the Departments anticipate that the overall impact will be minimal. However, there is a large degree of uncertainty regarding the effect of the final rules on any potential changes to cost sharing at the plan level so actual experience could differ.

Commenters suggested that the provisions of the 2020 proposed rules would disadvantage consumers with pre-existing conditions. Specifically, commenters suggested that those individuals most likely to shoulder the burden of increased out-of-pocket costs are those who already have higher medical expenses and out-of-pocket costs (for example, those with blood cancer). Another commenter noted that the 2020 proposed rules suggested that the resulting increases in out-of-pocket expenditures for participants and beneficiaries of grandfathered plans could be

³¹ See Kaiser Family Foundation, "2016 Employer Health Benefits Survey," available at <https://www.kff.org/health-costs/report/2016-employer-health-benefits-survey/>; Kaiser Family Foundation, "2017 Employer Health Benefits Survey," available at <https://www.kff.org/health-costs/report/2017-employer-health-benefits-survey/>; Kaiser Family Foundation, "2018 Employer Health Benefits Survey," available at <https://www.kff.org/health-costs/report/2018-employer-health-benefits-survey/>; and Kaiser Family Foundation, "2019 Employer Health Benefits Survey," available at <https://www.kff.org/health-costs/report/2019-employer-health-benefits-survey/>. Despite the relative stability between 2016 and 2019, the 2020 Employer Health Benefits Survey reported that the number of firms offering health coverage that offered at least one grandfathered plan in 2020 decreased to 16 percent. The Departments are of the view that this change may largely be attributable to issues with employer survey reporting during the COVID-19 pandemic, rather than to the 2015 final rules. The Kaiser Family Foundation reported a diminished response to the 2020 survey compared to previous years and attributed that lower response rate to a combination of factors including changing data collection firms, disruptions from the COVID-19 pandemic, and starting the fielding period later. Kaiser Family Foundation, "2020 Employer Health Benefits Survey," available at <https://www.kff.org/health-costs/report/2020-employer-health-benefits-survey/>.

offset by decreases in premiums or wage adjustments; however, according to this commenter, those potential benefits are minimal and uncertain, while participants and beneficiaries will likely be paying more for substandard health coverage. Another commenter suggested that the Departments should fully evaluate and publicly report on whether increased cost sharing will lead to decreased utilization of necessary medical care.

The Departments appreciate these concerns. Nevertheless, the Departments are of the view that finalizing the 2020 proposed rules is important to help grandfathered group health plans and grandfathered group health insurance coverage maintain grandfather status and supports the goal of promoting greater choice in coverage, especially in light of rising healthcare costs. The Departments recognize that should a grandfathered group health plan or grandfathered group health insurance coverage avail itself of the flexibilities in the final rules, some participants and beneficiaries could incur higher out-of-pocket costs for ongoing or future healthcare needs. However, as discussed previously in this preamble, participants and beneficiaries would continue to benefit from many PPACA consumer protections that are applicable to all group health plans and group health insurance coverage, regardless of grandfather status, including the prohibition on preexisting condition exclusions, the prohibition on waiting periods that exceed 90 days, and the prohibition on lifetime or annual dollar limits. Additionally, grandfathered group health plans and issuers of grandfathered group health insurance coverage are not prohibited from providing coverage consistent with any of PPACA market provisions that apply to non-grandfathered group health plans and may add coverage consistent with such market provisions without relinquishing grandfather status.

As discussed later in the impact analysis, some participants and beneficiaries could experience savings in reduced premiums, wage adjustments, and continued access to tax-advantaged HSAs due to changes made as a result of the final rules. The Departments recognize that any increases in cost sharing, changes in premiums, or wage adjustments are at the discretion of the issuer or grandfathered

group plan sponsor. The Departments are of the view that providing the flexibilities in the final rules could allow participants to retain their current coverage instead of finding alternate coverage, which may result in greater increases in cost-sharing or reduced benefits for those individuals. As noted later in the impact analysis, the Departments are of the view that because individuals with significant healthcare needs generally exceed the out-of-pocket limit for the plan year, they are only modestly affected by increases in cost-sharing requirements, while individuals with fewer healthcare needs are more likely to be affected by an increase in fixed-amount cost-sharing, but that they incur a small portion of the overall costs.

The Departments have concluded that the final rules strike a proper balance between preserving the ability to maintain existing coverage with the goals of expanding access to and improving the quality of health coverage.

Revenue Impact of Final Rules

This section of the preamble discusses the revenue impact of the final rules, considers a variety of approaches that employers offering grandfathered health plan coverage might have taken if the 2015 final rules were not amended, and compares the revenue impact of each approach under the 2015 final rules with the revenue impact under the final rules.

a. Employees who would have Remained in Grandfathered Plans and Coverage without the Final Rules

If the 2015 final rules were not amended, some employers might have chosen to continue to maintain their grandfathered health plan coverage. This subsection discusses the revenue impact that the final rules may have on this group of employers and employees.

Under the final rules, grandfathered group health plans and grandfathered group health insurance coverage will be allowed to increase fixed-amount cost-sharing requirements (such as copayments, deductibles, and out-of-pocket limits) at a somewhat higher rate than under the 2015 final rules without losing grandfather status, which may result in a pre-

mium reduction (or similar cost reduction for a self-insured plan). Specifically, for increases in fixed-amount cost-sharing on or after the applicability date of the final rules, grandfathered group health plans and grandfathered group health insurance coverage may use an alternative standard for determining the maximum percentage increase that relies on the premium adjustment percentage, rather than medical inflation, to the extent that it yields a greater result than the standard under the 2015 final rules.

The premium adjustment percentage is estimated to be about three percentage points higher than medical inflation in 2026, using FY2021 President's Budget projections of medical CPI and National Health Expenditures premium projections. Therefore, as of that year, fixed-amount copayments, deductibles, and out-of-pocket limits could be three percentage points higher under the final rules than under the 2015 final rules. However, a grandfathered group plan that increases fixed-amount cost-sharing to the maximum amount allowed under the final rules is likely to realize only a small reduction in premiums. This is because plans incur most of their costs for a relatively small fraction of participants—that is, from high-cost individuals. Because high-cost individuals generally exceed the out-of-pocket limit for the year, they are only modestly affected by higher out-of-pocket limits. Low-cost individuals are more likely to be affected by an increase in fixed-amount cost-sharing, but they incur a small portion of the overall costs. Therefore, the impact of the final rules for a particular grandfathered group health plan will depend on the parameters of covered benefits under the plan, as well as the distribution of expenditures for the plan participants. In addition, increased cost sharing could result in participants and beneficiaries making fewer visits to providers (that is, lower utilization), which could result in lower medical costs for some individuals, but higher costs for others who delay needed medical care. If individuals generally forgo unnecessary care, but continue to go to providers when necessary, premiums could decline even more, but this outcome is uncertain.

Because of the Federal tax exclusion for employer-sponsored coverage,

a premium reduction would increase tax revenues due to reduced employer contributions and employee pre-tax contributions made through a cafeteria plan. However, some employees might partially offset their increases in out-of-pocket payments through increased pre-tax contributions to health flexible spending arrangements (FSAs) or HSAs. Those potential increases in pre-tax contributions to health FSAs and HSAs would reduce tax revenues. Nonetheless, to the extent that employers would have continued to offer a grandfathered group health plan without changes to the 2015 final rules, under these final rules, the Departments expect tax revenues may increase slightly on net as a result of potential premium reductions. Further, there would be additional revenue gains to the extent that higher out-of-pocket payments discourage employees from continuing participation in the employer's group health plan. This increase may be offset by a reduction in revenue, however, if a reduction in premiums encourages non-participant employees to obtain coverage.

b. Employees who would no Longer have been Covered by Grandfathered Group Health Plans or Coverage without the Final Rules

If the 2015 final rules were not amended, some employers might have chosen to change their insured grandfathered group health plans to self-insured, non-grandfathered group health plans, rather than continue to comply with the 2015 final rules, which would result in little, if any, revenue change. Thus, with respect to these employers, the adoption of the final rules will have little, if any, revenue effect.

Alternatively, assuming the 2015 final rules were not amended, an employer might switch to a fully insured non-grandfathered non-HDHP group health plan. With respect to small employers, employees who would transfer to the non-grandfathered group health plan could improve the small group market risk pool or make it worse. An employer with a healthy population might be more likely to self-insure, whereas a small employer with a less healthy population might be more likely to join an insurance pool.

One commenter stated that because the non-grandfathered small group market is subject to modified community rating and single risk pool requirements, making it easier for small-group health plans to preserve their grandfather status would encourage firms with younger or healthier employees to find ways to opt out of the non-grandfathered small group market, at the expense of other firms that then would face higher premiums. The commenter noted that because premiums and medical claims costs in the small group market are higher for plans that are subject to all PPACA market reforms than for plans that are not, and because PPACA's changes to plan standards in the small group market were more significant than in the large group market, employees at small businesses have more to lose when employers avoid most PPACA market reforms. The commenter suggested that further extending grandfather status would only contribute to market segmentation that harms the non-grandfathered small-group market, rather than channeling younger and healthier groups into the insurance markets that generally are subject to PPACA market reforms, which would serve to bolster stability in those markets.

The Departments acknowledge that the existence of grandfathered group health plans potentially creates market segmentation in the small group market. However, to the extent such market segmentation exists, the Departments do not anticipate that the additional flexibilities provided in the final rules will increase segmentation since the final rules do not provide any mechanism for non-grandfathered plans to become grandfathered. Moreover, the Departments do not expect the number of plans that maintain grandfather status because of the final rules to be so significant as to exacerbate any market segmentation that may already exist.

Although the type of benefits covered in new, non-grandfathered plans (whether self-insured or fully insured) would likely be broader in some ways, such as for preventive care, the share of costs covered by the plan would likely decrease due to higher cost-sharing. Presumably, if the 2015 final rules were not amended, most employers would not make the switch from a grandfathered group health plan to a non-grandfathered group health plan

unless the overall cost of providing benefits would decrease, which would cause some revenue gain. (Again, though, the revenue gain could be partially offset by increases in the employees' pre-tax contributions to health FSAs or HSAs.) On the other hand, if the final rules enable an employer that otherwise might switch to a non-grandfathered group health plan to retain its grandfather plan, this revenue gain would not occur, resulting in a revenue loss compared to the status quo under the 2015 final rules.

Without the change to the 2015 final rules, some employers might replace their grandfathered group health plan with an individual coverage health reimbursement arrangement (individual coverage HRA). If the employer contributes a similar dollar amount to the individual coverage HRA as it currently does to the grandfathered group health plan, the employees' tax exclusion would be at least roughly the same as for the grandfathered group health plan. Moreover, the employees offered the individual coverage HRA would be as likely to be "firewalled" from obtaining a premium tax credit as if they had continued to participate in the grandfathered group health plan. Thus, under this scenario, there would be very little revenue effect from the final rules.

c. Termination of Employer-Sponsored Coverage

If the 2015 final rules were not amended, some employers might drop grandfathered group health coverage altogether and opt instead to make an employer shared responsibility payment, if required under section 4980H of the Code, which may result in an increase in federal revenue. In this case, all affected employees would qualify for a special enrollment period to enroll in other group coverage, if available, or individual health insurance coverage on or off the Exchange. Many of those employees with household incomes between 100-400 percent of the federal poverty level might qualify for financial assistance to help pay for their Exchange coverage and related healthcare expenses, which would increase federal outlays, as discussed further later in this section. Others might have household incomes too high to be eligible for a premi-

um tax credit or might receive a smaller tax subsidy through the income-related premium tax credit than through an employer-sponsored health insurance tax exclusion. Accordingly, if these employers continue their grandfathered group health plan under the final rules, there may be an associated revenue loss. Other employees could purchase individual health insurance coverage but receive a premium tax credit that is greater than the value of the tax exclusion for their current employer plans. For this population, the final rules may result in a revenue gain. However, the employees for which there would be a revenue gain are likely a small population for an employer that is currently offering a grandfathered group health plan.

Despite the availability of a special enrollment period, some affected employees might forgo enrolling in alternative health coverage and become uninsured or might opt instead to purchase short-term, limited-duration insurance. In this case, these employees would no longer receive a tax exclusion for the grandfathered group health plan, which, along with an employer shared responsibility payment, if any, may result in an increase in federal tax revenue. However, if these employees were to remain covered under a grandfathered group health plan as a result of the final rule, there may be a loss in federal revenue for this group.

Overall, there are a number of potential revenue effects of the final rules, some of which could offset each other. Additionally, there is a large degree of uncertainty, including uncertainty regarding how many group health plans would have continued as grandfathered plans absent the final rules and what alternatives would have been chosen by employers who would not have kept grandfathered group health plans absent the final rules, as well as how many grandfathered group health plans will make plan design changes as a result of the final rules. As a result, it is unclear whether these effects in the aggregate would result in a revenue gain or revenue loss. Because the employer market is

so large, even a small percentage change to aggregate premiums can result in large revenue changes. Nevertheless, the Departments are of the view that overall net effects are likely to be relatively small.

Regulatory Review Costs

Affected entities will need to understand the requirements of the final rules before they can avail themselves of any of the flexibilities in the final rules. Sponsors and issuers of grandfathered group health plan coverage will be responsible for ensuring compliance with the final rules should they seek to make changes to their grandfathered group health plans' cost-sharing requirements.

If regulations impose administrative costs on private entities, such as the time needed to read and interpret the final rules, the Departments seek to estimate the cost associated with regulatory review. Due to the uncertainty involved with accurately quantifying the number of entities that will review and interpret the final rules, the Departments assume that the total number of grandfathered group health plan coverage sponsors and issuers that will be able to avail themselves of the flexibilities provided by the final rules is a fair estimate of the number of entities affected. The Departments estimate 414,288 grandfathered plan sponsors and issuers of grandfathered group health insurance coverage will incur burdens related to reviewing the final rules.

The Departments acknowledge that this assumption may understate or overstate the costs of reviewing the final rules. It is possible that not all affected entities will review the final rules in detail and that others may seek the assistance of outside counsel to read and interpret the final rules. For example, firms providing or sponsoring a grandfathered group health plan may not read the final rules and might rely upon an issuer or a third-party administrator, if self-funded, to read and interpret the final rules. For these reasons, the Departments are of the view that the number of grand-

fathered group health plan coverage sponsors and issuers is a fair estimate of the number of reviewers of the final rules. The Departments sought, but did not receive, comments on the approach to estimating the number of affected entities that will review and interpret the final rules.

Using the wage information from the Bureau of Labor and Statistics (BLS) for a Compensation and Benefits Manager (Code 11-3111), the Departments estimate that the cost of reviewing the final rules is \$129.04 per hour, including overhead and fringe benefits.³² Assuming an average reading speed, the Departments estimate that it would take approximately 0.5 hour for the staff to review and interpret the final rules; therefore, the Departments estimate that the cost of reviewing and interpreting the final rules for each grandfathered group health plan coverage sponsor and issuer is approximately \$64.52. Thus, the Departments estimate that the overall cost for the estimated 414,288 grandfathered group health plan coverage sponsors and issuers will be \$26,729,861.76 ($\$64.52 \times 414,288$ total number of estimated grandfathered plan sponsors and issuers).³³

D. Regulatory Alternatives Considered

In developing the policies contained in the final rules, the Departments considered alternatives to the final rules. In the following paragraphs, the Departments discuss the key regulatory alternatives considered.

The Departments considered whether to modify each of the six types of changes, measured from March 23, 2010, that cause a group health plan or group health insurance coverage to cease to be grandfathered. To provide more flexibility regarding changes to fixed cost-sharing requirements, the Departments considered revising the definition of maximum percentage increase to increase the allowed percentage points that are added to medical inflation. However, the Departments are of the view that the final rules allow for the desired flexibility, while better

³² Wage information is available at https://www.bls.gov/oes/current/oes_nat.htm. Hourly wage rate is determined by multiplying the mean hourly wage by 100 percent to account for overhead and fringe benefits. The mean hourly wage for a Compensation and Benefit Manager (Code 11-3111) is \$64.52, when multiplied by 100 percent results in a total adjusted hourly wage of \$129.04.

³³ The total number of grandfathered plan sponsors and issuers of grandfathered group health insurance coverage, discussed earlier in the preamble, was derived from the total number of ERI-SA covered plan sponsors multiplied by the percentage of entities offering grandfathered health plans ($2.5 \text{ million} \times 0.16 = 400,000$), the number of state and local governments multiplied by the percentage of entities offering grandfathered health plans ($84,087 \times 0.16 = 13,454$), and the 834 issuers offering at least one grandfathered health plan ($400,000 + 13,454 + 834 = 414,288$).

reflecting underlying costs for grandfathered group health plans and grandfathered group health insurance coverage. The Departments acknowledge that the premium adjustment percentage, which the Departments incorporate into the definition of maximum percentage increase, reflects the changes in premiums in both the individual and group market, and that individual market premiums have increased faster than premiums in the group market. Due to the comparative sizes of the individual and group markets, however, the historically faster growth in the individual market has had a minimal impact on the premium adjustment percentage index. Therefore, the Departments are of the view that the premium adjustment percentage is an appropriate measure to incorporate into the definition of maximum percentage increase.

Another option the Departments considered was allowing a decrease in contribution rates by an employer or employee organization without triggering a loss of grandfather status. Under the 2015 final rules, an employer or employee organization cannot decrease contribution rates based on cost of coverage toward the cost of any tier of coverage for any class of similarly situated individuals by more than five percentage points below the contribution rate for the coverage period that included March 23, 2010 without losing grandfather status. The Departments considered permitting group health plans and group health insurance coverage with grandfather status to decrease the contribution rates by more than five percentage points. This change would increase employer flexibility, but the Departments were concerned that a decrease in the contribution rate could change the plan or coverage to such an extent that the plan or coverage could not reasonably be described as being the same plan or coverage that was offered on March 23, 2010. As a result, this option was not included in the final rules.

Another option the Departments considered was allowing a change to annual dollar limits for a group health plan or health insurance coverage without triggering a loss of grandfather status. Under the 2015 final rules, a group health plan or

group health insurance coverage that did not have an annual dollar limit on March 23, 2010, may not establish an annual dollar limit for any individual, whether provided in-network or out-of-network, without relinquishing grandfather status. If the plan or coverage had an annual dollar limit on March 23, 2010, it may not decrease the limit. Although for plan years beginning on or after January 1, 2014, group health plans and health insurance issuers generally may no longer impose annual or lifetime dollar limits on essential health benefits, permitting changes to annual dollar limits on benefits that are not essential health benefits may still represent a significant change to participants and beneficiaries who rely upon the benefits to which a limit is applied. Therefore, this option was not included in the final rules.

The Departments considered options to offset cost-sharing requirement changes by allowing sponsors of grandfathered group health plans and issuers of grandfathered group health insurance coverage to increase different types of cost-sharing requirements as long as any increase is offset by lowering another cost-sharing requirement to preserve the plan's or coverage's actuarial value. As discussed in previous rulemaking, however, an actuarial equivalency standard would allow a plan or coverage to make fundamental changes to the benefit design and still retain grandfather status, potentially conflicting with the goal of allowing participants and beneficiaries to retain health plans they like.³⁴ There would also be significant complexity involved in defining and determining actuarial value for these purposes, as well as significant burdens associated with administering and ensuring compliance with such rules. Therefore, the Departments did not include this option in the final rules.

The Departments considered changing the date of measurement for calculating whether changes to group health plans or health insurance coverage will cause a loss of grandfather status. For example, instead of looking at the cumulative change from March 23, 2010, the rules could measure the annual increases, starting from the applicability date of the final rules. However, the Departments concluded that this option could limit flexibility

for some employers. For example, some employers might want to keep the terms of the grandfathered group health plan the same for a few years and then make a more significant change later.

The Departments also considered making changes to the 2015 final rules to encourage more cost-effective care. One option the Departments considered was allowing unlimited changes to cost-sharing for out-of-network benefits. However, the Departments are concerned that unlimited discretion to change cost-sharing requirements for out-of-network benefits could result in changes to grandfathered group health plans or coverages so extensive that these plans or coverages could not reasonably be described as being the same plans or coverages that were offered on March 23, 2010. Additionally, the Departments decided that the change in the applicable index for medical inflation provides sufficient flexibility for fixed cost-sharing requirements. This option will give flexibility to grandfathered group health plans and grandfathered group health insurance coverage with respect to all fixed-amount cost-sharing requirements, including for out-of-network benefits.

E. Collection of Information Requirements

The final rules do not impose new information collection requirements; that is, reporting, recordkeeping, or third-party disclosure requirements. Consequently, there is no need for OMB review under the authority of the Paperwork Reduction Act of 1995 (44 U.S.C. 3501, *et seq.*). Though the final rules do not contain any new information collection requirements, the Departments are maintaining the current requirements that grandfathered plans maintain records documenting the terms of the plan in effect on March 23, 2010, include a statement in any summary of benefits that the plan or coverage believes it is grandfathered health plan coverage and that plans and coverages must provide contact information for participants to direct questions and complaints. Additionally, the Departments are maintaining the requirement that a grandfathered group health plan that is

³⁴ 75 FR 34538, 34547 (June 17, 2010).

changing health insurance issuers must provide the succeeding health insurance issuer documentation of plan terms under the prior health insurance coverage sufficient to determine whether the standards of paragraph 26 CFR 54.9815-1251(g)(1), 29 CFR 2590.715-1251(g)(1) and 45 CFR 147.140(g)(1) are met, and that insured group health plans (or multiemployer plans) that are grandfathered plans are required to notify the issuer (or multiemployer plan) if the contribution rate changes at any point during the plan year. The Departments do not anticipate that the final rules will make a substantive or material modification to the collections currently approved under the collection of information OMB control number 0938-1093 (CMS-10325), OMB control number 1210-0140 (DOL), and OMB control number 1545-2178 (Department of the Treasury).

F. Regulatory Flexibility Act

The Regulatory Flexibility Act, (5 U.S.C. 601, *et seq.*), requires agencies to prepare an initial regulatory flexibility analysis to describe the impact of final rules on small entities, unless the head of the agency can certify that the rules would not have a significant economic impact on a substantial number of small entities. The RFA generally defines a “small entity” as (1) a proprietary firm meeting the size standards of the Small Business Administration (SBA), (2) a not-for-profit organization that is not dominant in its field, or (3) a small government jurisdiction with a population of less than 50,000. States and individuals are not included in the definition of “small entity.” HHS uses a change in revenues of more than three to five percent as its measure of significant economic impact on a substantial number of small entities.

The final rules amend the 2015 final rules to allow greater flexibility for grandfathered group health plans and issuers of grandfathered group health insurance coverage. Specifically, the final rules specify that grandfathered group health plans that are HDHPs may make changes to fixed-

amount cost-sharing requirements that would otherwise cause a loss of grandfather status without causing a loss of grandfather status, but only to the extent those changes are necessary to comply with the requirements for being HDHPs under section 223(c)(2)(A) of the Code. The final rules also include a revised definition of maximum percentage increase that will provide an alternative method of determining the maximum percentage increase that is based on the premium adjustment percentage.

G. Impact of Regulations on Small Business – Department of Health and Human Services and the Department of Labor

The Departments are of the view that health insurance issuers would be classified under the North American Industry Classification System code 524114 (Direct Health and Medical Insurance Carriers). According to SBA size standards, entities with average annual receipts of \$41.5 million or less would be considered small entities for these North American Industry Classification System codes. Issuers could possibly be classified in 621491 (Health Maintenance Organization (HMO) Medical Centers) and, if this is the case, the SBA size standard would be \$35 million or less.³⁵ Few, if any, insurance companies underwriting comprehensive health insurance policies (in contrast, for example, to travel insurance policies or dental discount policies) fall below these size thresholds. Based on data from MLR annual report submissions for the 2019 MLR reporting year, approximately 74 out of 483 issuers of health insurance coverage nationwide had total premium revenue of \$41.5 million or less.³⁶ This estimate may overstate the actual number of small health insurance companies that may be affected, since over 68 percent of these small companies belong to larger holding groups. Most, if not all, of these small companies are likely to have non-health lines of business that will result in their revenues exceeding \$41.5 million, and it is likely not all of these companies

offer grandfathered group health plans or grandfathered group health coverage. The Departments do not expect any of these 74 potentially small entities to experience a change in revenues of more than three to five percent as a result of the final rules. Therefore, the Departments do not expect the provisions of the final rules to affect a substantial number of small entities. Due to the lack of knowledge regarding what small entities may decide to do with regard to the provisions in the final rules, the Departments are not able to precisely ascertain the economic effects on small entities. However, the Departments are of the view that the flexibilities provided for in the final rules will result in overall benefits for small entities by allowing them to make changes to certain cost-sharing requirements within limits and maintain their current grandfathered group health plans. The Departments sought, but did not receive, comments on ways that the 2020 proposed rules may impose additional costs and burdens on small entities.

For purposes of analysis under the RFA, the Employee Benefits Security Administration (EBSA) continues to consider a small entity to be an employee benefit plan with fewer than 100 participants.³⁷ The basis of this definition is found in section 104(a)(2) of ERISA, which permits the Secretary of Labor to prescribe simplified annual reports for pension plans that cover fewer than 100 participants. Under section 104(a)(3), the Secretary of Labor may also provide for exemptions or simplified annual reporting and disclosure for welfare benefit plans. Pursuant to the authority of section 104(a)(3), the DOL has previously issued at 29 CFR 2520.104–20, 2520.104–21, 2520.104–41, 2520.104–46 and 2520.104b–10 certain simplified reporting provisions and limited exemptions from reporting and disclosure requirements for small plans, including unfunded or insured welfare plans covering fewer than 100 participants and satisfying certain other requirements. Further, while some large employers may have small plans, in general small employers maintain most small plans. Thus, EBSA believes that assessing the impact of the final rules on

³⁵ “Table of Small Business Size Standards Matched to North American Industry Classification System Codes.” U.S. Small Business Administration, available at https://www.sba.gov/sites/default/files/2019-08/SBA%20Table%20of%20Size%20Standards_Effective%20Aug%2019%2C%202019_Rev.pdf.

³⁶ “Medical Loss Ratio Data and System Resources.” CCHIO, available at <https://www.cms.gov/CCHIO/Resources/Data-Resources/mlr.html>.

³⁷ The DOL consulted with the SBA in making this determination as required by 5 U.S.C. 603(c) and 13 CFR 121.903(c).

small plans is an appropriate substitute for evaluating the effect on small entities. The definition of small entity considered appropriate for this purpose differs, however, from a definition of small business that is based on size standards promulgated by the SBA (13 CFR 121.201) pursuant to the Small Business Act (15 U.S.C. 631 *et seq.*). Therefore, EBSA requested, but did not receive, comments on the appropriateness of the size standard used in evaluating the impact of the final rules on small entities.

H. Impact of Regulations on Small Business – Department of the Treasury

Pursuant to section 7805(f) of the Code, the proposed rules that preceded these final rules were submitted to the Chief Counsel for Advocacy of the SBA for comment on their impact on small business, and no comments were received.

I. Effects on small rural hospitals

Section 1102(b) of the SSA (42 U.S.C. 1302) requires agencies to prepare an RIA if a rule may have a significant impact on the operations of a substantial number of small rural hospitals. This analysis must conform to the provisions of section 604 of the RFA. For purposes of section 1102(b) of the SSA, HHS defines a small rural hospital as a hospital that is located outside of a metropolitan statistical area and has fewer than 100 beds. The final rules would not materially affect small rural hospitals. Therefore, while the final rules are not subject to section 1102(b) of the SSA, the Departments have determined that the final rules will not have a significant impact on the operations of a substantial number of small rural hospitals.

J. Unfunded Mandates

Section 202 of the Unfunded Mandates Reform Act of 1995 (UMRA) requires that agencies assess anticipated costs and benefits and take certain actions before issuing a final rule that includes any federal mandate that may result in expenditures in any one year by state, local, or tribal governments, in the aggregate, or by the private sector, of \$100 million in 1995 dollars, updated annually for inflation.

In 2020, that threshold is approximately \$156 million.

While the Departments recognize that some state, local, and tribal governments may sponsor grandfathered health plan coverage, the Departments do not expect any state, local, or tribal government to incur any additional costs associated with the final rules. The Departments estimate that any costs associated with the final rules will not exceed the \$156 million threshold. Thus, the Departments conclude that the final rules will not impose an unfunded mandate on state, local, or tribal governments or the private sector.

K. Federalism

Executive Order 13132 establishes certain requirements that an agency must meet when it issues a proposed rule that imposes substantial direct costs on state and local governments, preempts state law, or otherwise has federalism implications. Federal agencies promulgating regulations that have federalism implications must consult with state and local officials and describe the extent of their consultation and the nature of the concerns of state and local officials in the preamble to the regulation.

In the Departments' view, the final rules do not have any federalism implications. They simply provide grandfathered group health plan sponsors and issuers more flexibility to increase fixed-amount cost-sharing requirements and to make changes to fixed-amount cost-sharing requirements in grandfathered group health plans and grandfathered group health insurance coverage that are HDHPs to the extent those changes are necessary to comply with the requirements for HDHPs under section 223(c)(2)(A) of the Code, without causing the plan or coverage to relinquish its grandfather status. The Departments recognize that some state, local, and tribal governments may sponsor grandfathered health plan coverage. The final rules will provide these entities with additional flexibility.

In general, through section 514, ERISA supersedes state laws to the extent that they relate to any covered employee benefit plan, and preserves state laws that regulate insurance, banking, or securities. While ERISA prohibits states from regulating a

plan as an insurance or investment company or bank, the preemption provisions of section 731 of ERISA and section 2724 of the PHS Act (implemented in 29 CFR 2590.731(a) and 45 CFR 146.143(a)) apply so that the requirements in title XXVII of the PHS Act (including those enacted by PPACA) are not to be "construed to supersede any provision of state law which establishes, implements, or continues in effect any standard or requirement solely relating to health insurance issuers in connection with group health insurance coverage except to the extent that such standard or requirement prevents the application of a 'requirement of a federal standard.'" The conference report accompanying HIPAA indicates that this is intended to be the "narrowest" preemption of states' laws (see House Conf. Rep. No. 104-736, at 205, reprinted in 1996 U.S. Code Cong. & Admin. News 2018). States may continue to apply state law requirements to health insurance issuers except to the extent that such requirements prevent the application of PHS Act requirements that are the subject of this rulemaking. Accordingly, states have significant latitude to impose requirements on health insurance issuers that are more restrictive than the federal law.

In compliance with the requirement of Executive Order 13132 that agencies examine closely any policies that may have federalism implications or limit the policy making discretion of the states, the Departments have engaged in efforts to consult with and work cooperatively with affected states, including participating in conference calls with and attending conferences of the National Association of Insurance Commissioners, and consulting with state insurance officials on an individual basis. While developing the final rules, the Departments attempted to balance the states' interests in regulating health insurance issuers with Congress' intent to provide uniform minimum protections to consumers in every state. By doing so, it is the Departments' view that they have complied with the requirements of Executive Order 13132.

Pursuant to the requirements set forth in section 8(a) of Executive Order 13132, and by the signatures affixed to the final rules, the Departments certify that the Department of the Treasury, EBSA, and

CMS have complied with the requirements of Executive Order 13132 for the attached final rules in a meaningful and timely manner.

L. Reducing Regulation and Controlling Regulatory Costs

Executive Order 13771, entitled “Reducing Regulation and Controlling Regulatory Costs,” was issued on January 30, 2017, and requires that the costs associated with significant new regulations “shall, to the extent permitted by law, be offset by the elimination of existing costs associated with at least two prior regulations.” It has been determined that the final rules are an action that primarily results in transfers and does not impose more than *de minimis* costs as described above and thus is not a regulatory or de-regulatory action for the purposes of Executive Order 13771.

V. Statutory Authority

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

The Department of Labor regulations are adopted pursuant to the authority contained in 29 U.S.C. 1027, 1059, 1135, 1161-1168, 1169, 1181-1183, 1181 note, 1185, 1185a, 1185b, 1191, 1191a, 1191b, and 1191c; section 101(g), Pub-

lic Law 104-191, 110 Stat. 1936; section 401(b), Public Law 105-200, 112 Stat. 645 (42 U.S.C. 651 note); section 512(d), Public Law 110-343, 122 Stat. 3881; section 1001, 1201, and 1562(e), Public Law 111-148, 124 Stat. 119, as amended by Public Law 111-152, 124 Stat. 1029; Secretary of Labor’s Order 6-2009, 74 FR 21524 (May 7, 2009).

The Department of Health and Human Services regulations are adopted pursuant to the authority contained in sections 2701 through 2763, 2791, and 2792 of the PHS Act (42 U.S.C. 300gg through 300gg-63, 300gg-91, and 300gg-92), as amended.

List of Subjects

26 CFR Part 54

Excise taxes, Health care, Health insurance, Pensions, Reporting and recordkeeping requirements.

29 CFR Part 2590

Employee benefit plans, Health care, Health insurance, Penalties, Pensions, Privacy, Reporting and recordkeeping requirements.

45 CFR Part 147

Age discrimination, Citizenship and naturalization, Civil rights, Health care, Health insurance, Individuals with dis-

abilities, Intergovernmental relations, Reporting and recordkeeping requirements, Sex discrimination.

Sunita Lough,
Deputy Commissioner for Services
and Enforcement,
Internal Revenue Service.

Approved: December 7, 2020.

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

Jeanne Klinefelter Wilson,
Acting Assistant Secretary,
Employee Benefits Security Adminis-
tration,
U.S. Department of Labor.

Dated: December 9, 2020.

Seema Verma,
Administrator,
Centers for Medicare & Medicaid
Services.

Dated: November 30, 2020.

Alex M. Azar II,
Secretary,
Department of Health and Human
Services.

Dated: December 2, 2020.

DEPARTMENT OF THE TREASURY

Internal Revenue Service

Amendments to the Regulations

Accordingly, the Internal Revenue Service, Department of the Treasury, amends 26 CFR part 54 as follows:

PART 54—PENSION EXCISE TAXES

Paragraph 1. The authority citation for part 54 continues to read, in part, as follows:

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

* * * * *

Par. 2. Section 54.9815-1251 is as amended:

a. By revising the first sentence of paragraph (g)(1) introductory text;

b. By revising paragraphs (g)(1)(iii), (g)(1)(iv)(A) and (B), and (g)(1)(v);

c. By redesignating paragraphs (g)(3) and (4) as paragraphs (g)(4) and (5);

d. By adding a new paragraph (g)(3);

e. By revising newly redesignated paragraphs (g)(4)(i) and (ii); and

f. In newly redesignated paragraph (g)(5):

i. By revising Examples 3 and 4;

ii. By redesignating Examples 5 through 9 as Examples 6 through 10;

iii. By adding a new Example 5;

iv. By revising newly redesignated Examples 6 through 10; and

v. By adding Example 11.

The revisions and additions read as follows:

§ 54.9815-1251 Preservation of right to maintain existing coverage.

* * * * *

(g) * * *

(1) * * * Subject to paragraphs (g)(2) and (3) of this section, the rules of this paragraph (g)(1) describe situations in which a group health plan or health insurance coverage ceases to be a grandfathered health plan. * * *

* * * * *

(iii) *Increase in a fixed-amount cost-sharing requirement other than a copayment.* Any increase in a fixed-amount cost-sharing requirement other than a copayment (for example, deductible or out-of-pocket limit), determined as of the effective date of the increase, causes a group health plan or health insurance coverage to cease to be a grandfathered health plan, if the total percentage increase in the cost-sharing requirement measured from March 23, 2010 exceeds the maximum percentage increase (as defined in paragraph (g)(4)(ii) of this section).

(iv) * * *

(A) An amount equal to \$5 increased by medical inflation, as defined in paragraph (g)(4)(i) of this section (that is, \$5 times medical inflation, plus \$5); or

(B) The maximum percentage increase (as defined in paragraph (g)(4)(ii) of this section), determined by expressing the total increase in the copayment as a percentage.

(v) *Decrease in contribution rate by employers and employee organizations—*

(A) *Contribution rate based on cost of coverage.* A group health plan or group health insurance coverage ceases to be a grandfathered health plan if the employer or employee organization decreases its contribution rate based on cost of coverage (as defined in paragraph (g)(4)(iii)(A) of this section) towards the cost of any tier of coverage for any class of similarly situated individuals (as described in §54.9802(d)) by more than 5 percentage points below the contribution rate for the coverage period that includes March 23, 2010.

(B) *Contribution rate based on a formula.* A group health plan or group health insurance coverage ceases to be a grandfathered health plan if the employer or employee organization decreases its contribution rate based on a formula (as defined in paragraph (g)(4)(iii)(B) of this section) towards the cost of any tier of coverage for any class of similarly situated individuals (as described in §54.9802(d)) by more than 5 percent below the contribution rate for the coverage period that includes March 23, 2010.

* * * * *

(3) *Special rule for certain grandfathered high deductible health plans.* With respect to a grandfathered group health

plan or group health insurance coverage that is a high deductible health plan within the meaning of section 223(c)(2), increases to fixed-amount cost-sharing requirements made effective on or after June 15, 2021 that otherwise would cause a loss of grandfather status will not cause the plan or coverage to relinquish its grandfather status, but only to the extent such increases are necessary to maintain its status as a high deductible health plan under section 223(c)(2)(A).

(4) * * *

(i) *Medical inflation defined.* For purposes of this paragraph (g), the term *medical inflation* means the increase since March 2010 in the overall medical care component of the Consumer Price Index for All Urban Consumers (CPI-U) (unadjusted) published by the Department of Labor using the 1982-1984 base of 100. For purposes of this paragraph (g)(4)(i), the increase in the overall medical care component is computed by subtracting 387.142 (the overall medical care component of the CPI-U (unadjusted) published by the Department of Labor for March 2010, using the 1982-1984 base of 100) from the index amount for any month in the 12 months before the new change is to take effect and then dividing that amount by 387.142.

(ii) *Maximum percentage increase defined.* For purposes of this paragraph (g), the term *maximum percentage increase* means:

(A) With respect to increases for a group health plan and group health insurance coverage made effective on or after March 23, 2010, and before June 15, 2021, medical inflation (as defined in paragraph (g)(4)(i) of this section), expressed as a percentage, plus 15 percentage points; and

(B) With respect to increases for a group health plan and group health insurance coverage made effective on or after June 15, 2021, the greater of:

(I) Medical inflation (as defined in paragraph (g)(4)(i) of this section), expressed as a percentage, plus 15 percentage points; or

(2) The portion of the premium adjustment percentage, as defined in 45 CFR 156.130(e), that reflects the relative change between 2013 and the calendar year prior to the effective date of the increase (that is, the premium adjustment

percentage minus 1), expressed as a percentage, plus 15 percentage points.

* * * * *

(5) * * *

Example 3. (i) *Facts.* On March 23, 2010, a grandfathered group health plan has a copayment requirement of \$30 per office visit for specialists. The plan is subsequently amended to increase the copayment requirement to \$40, effective before June 15, 2021. Within the 12-month period before the \$40 copayment takes effect, the greatest value of the overall medical care component of the CPI-U (unadjusted) is 475.

(ii) *Conclusion.* In this *Example 3*, the increase in the copayment from \$30 to \$40, expressed as a percentage, is 33.33% ($40 - 30 = 10$; $10 \div 30 = 0.3333$; $0.3333 = 33.33\%$). Medical inflation (as defined in paragraph (g)(4)(i) of this section) from March 2010 is 0.2269 ($475 - 387.142 = 87.858$; $87.858 \div 387.142 = 0.2269$). The maximum percentage increase permitted is 37.69% ($0.2269 = 22.69\%$; $22.69\% + 15\% = 37.69\%$). Because 33.33% does not exceed 37.69%, the change in the copayment requirement at that time does not cause the plan to cease to be a grandfathered health plan.

Example 4. (i) *Facts.* Same facts as *Example 3* of this paragraph (g)(5), except the grandfathered group health plan subsequently increases the \$40 copayment requirement to \$45 for a later plan year, effective before June 15, 2021. Within the 12-month period before the \$45 copayment takes effect, the greatest value of the overall medical care component of the CPI-U (unadjusted) is 485.

(ii) *Conclusion.* In this *Example 4*, the increase in the copayment from \$30 (the copayment that was in effect on March 23, 2010) to \$45, expressed as a percentage, is 50% ($45 - 30 = 15$; $15 \div 30 = 0.5$; $0.5 = 50\%$). Medical inflation (as defined in paragraph (g)(4)(i) of this section) from March 2010 is 0.2527 ($485 - 387.142 = 97.858$; $97.858 \div 387.142 = 0.2527$). The increase that would cause a plan to cease to be a grandfathered health plan under paragraph (g)(1)(iv) of this section is the greater of the maximum percentage increase of 40.27% ($0.2527 = 25.27\%$; $25.27\% + 15\% = 40.27\%$), or \$6.26 ($5 \times 0.2527 = \1.26; $\$1.26 + \$5 = \$6.26$). Because 50% exceeds 40.27% and \$15 exceeds \$6.26, the change in the copayment requirement at that time causes the plan to cease to be a grandfathered health plan.

Example 5. (i) *Facts.* Same facts as *Example 4* of this paragraph (g)(5), except the grandfathered group health plan increases the copayment requirement to \$45, effective after June 15, 2021. The greatest value of the overall medical care component of the CPI-U (unadjusted) in the preceding 12-month period is still 485. In the calendar year that includes the effective date of the increase, the applicable portion of the premium adjustment percentage is 36%.

(ii) *Conclusion.* In this *Example 5*, the grandfathered health plan may increase the copayment by the greater of: medical inflation, expressed as a percentage, plus 15 percentage points; or the applicable portion of the premium adjustment percentage for the calendar year that includes the effective date

of the increase, plus 15 percentage points. The latter amount is greater because it results in a 51% maximum percentage increase ($36\% + 15\% = 51\%$) and, as demonstrated in *Example 4* of this paragraph (g)(5), determining the maximum percentage increase using medical inflation yields a result of 40.27%. The increase in the copayment, expressed as a percentage, is 50% ($45 - 30 = 15$; $15 \div 30 = 0.5$; $0.5 = 50\%$). Because the 50% increase in the copayment is less than the 51% maximum percentage increase, the change in the copayment requirement at that time does not cause the plan to cease to be a grandfathered health plan.

Example 6. (i) *Facts.* On March 23, 2010, a grandfathered group health plan has a copayment of \$10 per office visit for primary care providers. The plan is subsequently amended to increase the copayment requirement to \$15, effective before June 15, 2021. Within the 12-month period before the \$15 copayment takes effect, the greatest value of the overall medical care component of the CPI-U (unadjusted) is 415.

(ii) *Conclusion.* In this *Example 6*, the increase in the copayment, expressed as a percentage, is 50% ($15 - 10 = 5$; $5 \div 10 = 0.5$; $0.5 = 50\%$). Medical inflation (as defined in paragraph (g)(4)(i) of this section) from March 2010 is 0.0720 ($415.0 - 387.142 = 27.858$; $27.858 \div 387.142 = 0.0720$). The increase that would cause a group plan to cease to be a grandfathered health plan under paragraph (g)(1)(iv) of this section is the greater of the maximum percentage increase of 22.20% ($0.0720 = 7.20\%$; $7.20\% + 15\% = 22.20\%$), or \$5.36 ($\$5 \times 0.0720 = \0.36 ; $\$0.36 + \$5 = \$5.36$). The \$5 increase in copayment in this *Example 6* would not cause the plan to cease to be a grandfathered health plan pursuant to paragraph (g)(1)(iv) of this section, which would permit an increase in the copayment of up to \$5.36.

Example 7. (i) *Facts.* Same facts as *Example 6* of this paragraph (g)(5), except on March 23, 2010, the grandfathered health plan has no copayment (\$0) for office visits for primary care providers. The plan is subsequently, amended to increase the copayment requirement to \$5, effective before June 15, 2021.

(ii) *Conclusion.* In this *Example 7*, medical inflation (as defined in paragraph (g)(4)(i) of this section) from March 2010 is 0.0720 ($415.0 - 387.142 = 27.858$; $27.858 \div 387.142 = 0.0720$). The increase that would cause a plan to cease to be a grandfathered health plan under paragraph (g)(1)(iv)(A) of this section is \$5.36 ($\$5 \times 0.0720 = \0.36 ; $\$0.36 + \$5 = \$5.36$). The \$5 increase in copayment in this *Example 7* is less than the amount calculated pursuant to paragraph (g)(1)(iv)(A) of this section of \$5.36. Thus, the \$5 increase in copayment does not cause the plan to cease to be a grandfathered health plan.

Example 8. (i) *Facts.* On March 23, 2010, a self-insured group health plan provides two tiers of coverage—self-only and family. The employer contributes 80% of the total cost of coverage for self-only and 60% of the total cost of coverage for family. Subsequently, the employer reduces the contribution to 50% for family coverage, but keeps the same contribution rate for self-only coverage.

(ii) *Conclusion.* In this *Example 8*, the decrease of 10 percentage points for family coverage in the contribution rate based on cost of coverage causes the plan to cease to be a grandfathered health plan. The fact that the contribution rate for self-only coverage remains the same does not change the result.

Example 9. (i) *Facts.* On March 23, 2010, a self-insured grandfathered health plan has a COBRA premium for the 2010 plan year of \$5,000 for self-only coverage and \$12,000 for family coverage. The required employee contribution for the coverage is \$1,000 for self-only coverage and \$4,000 for family coverage. Thus, the contribution rate based on cost of coverage for 2010 is 80% ($(\$5,000 - \$1,000) / \$5,000$) for self-only coverage and 67% ($(\$12,000 - \$4,000) / \$12,000$) for family coverage. For a subsequent plan year, the COBRA premium is \$6,000 for self-only coverage and \$15,000 for family coverage. The employee contributions for that plan year are \$1,200 for self-only coverage and \$5,000 for family coverage. Thus, the contribution rate based on cost of coverage is 80% ($(\$6,000 - \$1,200) / \$6,000$) for self-only coverage and 67% ($(\$15,000 - \$5,000) / \$15,000$) for family coverage.

(ii) *Conclusion.* In this *Example 9*, because there is no change in the contribution rate based on cost of coverage, the plan retains its status as a grandfathered health plan. The result would be the same if all or part of the employee contribution was made pre-tax through a cafeteria plan under section 125.

Example 10. (i) *Facts.* A group health plan not maintained pursuant to a collective bargaining agreement offers three benefit packages on March 23, 2010. Option F is a self-insured option. Options G and H are insured options. Beginning July 1, 2013, the plan increases coinsurance under Option H from 10% to 15%.

(ii) *Conclusion.* In this *Example 10*, the coverage under Option H is not grandfathered health plan coverage as of July 1, 2013, consistent with the rule in paragraph (g)(1)(ii) of this section. Whether the coverage under Options F and G is grandfathered health plan coverage is determined separately under the rules of this paragraph (g).

Example 11. (i) *Facts.* A group health plan that is a grandfathered health plan and also a high deductible health plan within the meaning of section 223(c)(2) had a \$2,400 deductible for family coverage on March 23, 2010. The plan is subsequently amended after June 15, 2021 to increase the deductible limit by the amount that is necessary to comply with the requirements for a plan to qualify as a high deductible health plan under section 223(c)(2)(A), but that exceeds the maximum percentage increase.

(ii) *Conclusion.* In this *Example 11*, the increase in the deductible at that time does not cause the plan to cease to be a grandfathered health plan because the increase was necessary for the plan to continue to satisfy the definition of a high deductible health plan under section 223(c)(2)(A).

(Filed by the Office of the Federal Register on December 11, 2020, 8:45 am., and published in the issue of the Federal Register for December 15, 2020, 85 F.R. 81097)

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.
FR—Federal Register.
FUTA—Federal Unemployment Tax Act.
FX—Foreign corporation.
G.C.M.—Chief Counsel's Memorandum.
GE—Grantee.
GP—General Partner.
GR—Grantor.
IC—Insurance Company.
I.R.B.—Internal Revenue Bulletin.
LE—Lessee.
LP—Limited Partner.
LR—Lessor.
M—Minor.
Nonacq.—Nonacquiescence.
O—Organization.
P—Parent Corporation.
PHC—Personal Holding Company.
PO—Possession of the U.S.
PR—Partner.
PRS—Partnership.

PTE—Prohibited Transaction Exemption.
Pub. L.—Public Law.
REIT—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
S—Subsidiary.
S.P.R.—Statement of Procedural Rules.
Stat.—Statutes at Large.
T—Target Corporation.
T.C.—Tax Court.
T.D.—Treasury Decision.
TFE—Transferee.
TFR—Transferor.
T.I.R.—Technical Information Release.
TP—Taxpayer.
TR—Trust.
TT—Trustee.
U.S.C.—United States Code.
X—Corporation.
Y—Corporation.
Z—Corporation.

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¹ A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2020–27 through 2020–52 is in Internal Revenue Bulletin 2020–52, dated December 27, 2020.

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