Current Federal Tax Developments

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SECTION: 162
SURVIVING SPOUSE CAN DEDUCT INHERITED FARM INPUTS PREVIOUSLY DEDUCTED WHEN PURCHASED IN PRIOR YEAR BY DECEDENT

Citation: Estate of Steve K. Backemeyer et al v. Commissioner, 147 TC No. 17, 12/8/16

Steve Backemeyer, a cash basis farmer, purchased seed, chemicals, fertilizer and fuel in 2010 which he intended to use when planting crops in 2011. Being on the cash basis, these items were deducted on his 2010 income tax return, filing married filing joint with his wife. However, Steve died in March 2011 and these supplies were inherited by his wife. His wife took up the farming business, using these supplies to plant the crop in 2011. She claimed these items, valued as of the date of Steve's death, as a deduction on her 2011 return, also a joint return filed with her deceased husband.

In the case of *Estate of Steve K. Backemeyer et al v. Commissioner*, 147 TC No. 17 the IRS argued that the tax benefit should prevent this double deduction of the same expenses for the same crop, requiring the deduction to be removed from the taxpayers' 2010 tax return. But the Tax Court found that both deductions were allowed in this situation.

The IRS argued that the case was governed by the result in the *Bliss Dairy v. United States* case (460 US 370 (1983)). The Tax Court summarized that case as follows:

> *Bliss Dairy*, 460 U.S. at 374, involved a closely held corporation which used the cash method of accounting and engaged in the business of operating a dairy. Close to the end of its taxable year, the corporation deducted on purchase the full cost of cattle feed bought for use in its operations. *Id*. Shortly after the beginning of its next taxable year, with a substantial portion of the feed still on hand, the corporation liquidated and distributed its assets to its shareholders in a nontaxable transaction. *Id*. at 374-375. The shareholders continued operating the dairy business in noncorporate form and in turn deducted their basis in the feed as an expense of doing business. *Id*. at 376. The Supreme Court held that the liquidation of the corporation resulted in conversion of the cattle feed from a business to a nonbusiness use, representing an action inconsistent with the prior deduction and requiring application of the tax benefit rule. *Id*. at 395-402.

The IRS argued that the same sort of conversion to nonbusiness use of the farm inputs occurred here. As the Court summarizes:

> Respondent argues that the facts here are nearly identical to those of Bliss Dairy. When Mr. Backemeyer died not having used the farm inputs in his sole proprietor farming operation, respondent opines, the farm inputs were converted to a nonbusiness use when they were distributed to the Backemeyer Family Trust. When Mrs. Backemeyer received the assets, she took them with a stepped-up basis and contributed them to her sole proprietor farming business. Therefore, respondent asserts, upon Mr. Backemeyer's death the farm inputs were converted from business to personal use, and Mrs. Backemeyer converted them back from personal to business use. According to respondent, this entitles Mrs. Backemeyer to a deduction under section 162 but also requires Mr. Backemeyer to recognize income related to his conversion of the property from one use to another.

The taxpayer disagreed with this view. The Court summarized the taxpayer's position as follows:

> Much of petitioners' argument rests on the proposition that when Mrs. Backemeyer inherited the farm inputs from her late husband and used them in her own farming operation, she is deemed to have simultaneously sold the inputs and then purchased them for use in farming, with the deemed sale resulting in no gain because she had a full stepped-up basis in the farm inputs. Petitioners insist that they should be regarded separately with respect to the separate Schedules F that they filed for the 2011 tax year (respondent in his answering brief concedes this point). According to petitioners, the stepped-up basis with which Mrs. Backemeyer took the farm inputs gave her a "fresh start" with respect to the

> tax attributes of these inherited assets. Petitioners point out that this is "not some elaborate scheme to create a double deduction" but is an unusual circumstance that occurred as a result of Mr. Backemeyer's death.

The Tax Court found the IRS had misinterpreted *Bliss Dairy* in this case. The Court found that the proper way to view *Bliss Dairy's* interpretation of the tax benefit rule is as follows:

> In *Bliss Dairy*, 460 U.S. at 381, the Supreme Court observed that the purpose of the tax benefit rule is "to approximate the results produced by a tax system based on transactional rather than annual accounting." It is intended "to achieve rough transactional parity in tax * * * and to protect the Government and the taxpayer from the adverse effects of reporting a transaction on the basis of assumptions that an event in a subsequent year proves to have been erroneous." *Id*. at 383. The rule's application is not automatic. It applies "only when a careful examination shows that the later event is indeed fundamentally inconsistent with the premise on which the deduction was initially based." Id. This means that "if that event had occurred within the same taxable year, it would have foreclosed the deduction." *Id*. at 383-384.

The opinion noted that in case of *Frederick v. Commissioner*, 101 T.C. 35, 41 (1993) the Tax Court had outlined a four factor test that would determine if the tax benefit rule of *Bliss Dairy* should apply:

- The amount was deducted in a year prior to the current year,
- The deduction resulted in a tax benefit,
- An event occurs in the current year that is fundamentally inconsistent with the premises on which the deduction was originally based, and
- A nonrecognition provision of the Internal Revenue Code does not prevent the inclusion in gross income.

The Tax Court notes that the first two tests are met in this case—the amount was deducted in 2010 and it resulted in a tax benefit.

But the Court found the nature of the operation of the estate tax and the inherited basis rules did create an event fundamentally inconsistent with the premises on which the original deduction was based. The Court notes:

> The reason for this is that the estate tax effectively "recaptures" section 162 deductions by way of its normal operation, obviating any need to separately apply the tax benefit rule. When Mr. Backemeyer died, all of his assets, including the farm inputs, became subject to the estate tax, which operates similarly to a mark-to-market tax when the mark-to-market tax is imposed on zero-basis assets. Compare sec. 2001(a) (imposing a tax "on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States"), and sec. 2051 (defining the value of a taxable estate as the value of the gross estate less certain deductions provided for in the estate tax), and sec. 2031 (defining the value of a gross estate as the value at the time of decedent's death "of all property, real or personal, tangible or intangible, wherever situated"), with, e.g., sec. 877A (imposing an exit tax on U.S. citizens and long-term residents relinquishing citizenship or lawful permanent residence, respectively, by requiring that "[a]ll property of a covered expatriate shall be treated as sold on the day before the expatriation date for its fair market value"). The farm inputs were included in Mr. Backemeyer's estate at their fair market value, see sec. 2031, which the parties have stipulated to be equal to the farm inputs' purchase price. Since the farm inputs had a basis of zero, they were subject to the estate tax on the same base as their purchase price, for which Mr. Backemeyer had claimed a section 162 deduction for 2010.

The imposition of the estate tax meant that there was (in theory) a tax cost imposed when Mr. Backemeyer died. However, even if Mr. Backenmeyer's estate exceeded the maximum that could generally pass tax free, the fact

it went to Mrs. Backenmeyer meant that no tax would actually be imposed. However, that fact did not make a difference to the Tax Court in this case.

The Court also found that a death was fundamentally different from the liquidation transaction in *Bliss Dairy*. The Court notes:

> Whereas liquidation of a corporation or a sale of expensed business inputs entails some level of forethought and affirmative intent to act accordingly, death ordinarily does not involve such planning. As the Court of Appeals for the Eighth Circuit has observed, while death may be beneficial for tax purposes, it is difficult to regard it as a tax avoidance scheme. *Estate of Peterson v. Commissioner*, 667 F.2d 675, 681-682 (8th Cir. 1981), aff'g 74 T.C. 630 (1980). Under the Supreme Court's *Bliss Dairy* standard, death is the quintessential "merely unexpected event." Were death fundamentally inconsistent with expensing business inputs, every sole proprietor in the year of his death would face double taxation under both the income tax and the estate tax on all the inputs he had purchased for but not yet used in his business. We are loath to interpret Bliss Dairy to stand for the proposition that any time a sole proprietor dies, all of his expensed assets are subject to recapture. The Supreme Court has refused to accept such a rule, see *Bliss Dairy*, 460 U.S. at 386 n.20, as do we.

The Court notes the double deduction that the IRS is worried about is triggered solely by IRC §1014(a):

> The sole cause for the allowance of two deductions here is section 1014(a), which steps up the basis of property acquired from a decedent. Were section 1014 not to apply, then Mrs. Backemeyer would have received the farm inputs with a zero basis and therefore been unable to deduct them. We find it unlikely that respondent would have pursued his tax benefit rule argument were that the case. Since "Congress presumably enacts legislation with knowledge of the law," *CRI-Leslie, LLC v. Commissioner*, 147 T.C. ___, ___ (slip op. at 13) (Sept. 7, 2016), we conclude that had Congress wished to foreclose a second section 162 deduction as a result of a section 1014 basis step-up, it would have so provided.

The Court also notes that the fourth criteria is not met either, since the tax law provides that a disposition by death is not a recognition event—or, as the Court puts it, "nonrecognition on death is among the strongest principles inherent in the income tax."

SECTION: 501
GROUP OF FRANCHISEES OF SINGLE ORGANIZATION DID NOT QUALIFY AS §501(C)(6) ORGANIZATION

Citation: PLR 201649017, 12/2/16

The organization in LTR 201649017 was found to be pursuing too narrow of a business interest to qualify as an exempt business league under IRC §501(c)(6), thus its request for exemption was denied.

IRC §501(c) contains a list of exempt organizations. IRC §501(c)(6) provides that one of those exempt organizations is:

> (6) Business leagues, chambers of commerce, real-estate boards, boards of trade, or professional football leagues (whether or not administering a pension fund for football players), not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual.

In this case the organization consisted of a group of franchisees of the same organization. The group described its exempt purpose as:

- Educating and helping franchisee members with the N's current and new policies;
- Communicating and finding resolution of member owners issues to N's executives;

- Presenting and communicating the unresolved and disputed issues of franchisees to the O president group;
- Hosting trade shows with the vendors for the mutual benefit of franchisees and vendors. This provides franchisees the opportunity to build one-to-one relationships with the vendors and vice-versa.

The organization's position was that its operations should qualify it as a business league.

The IRC's definition is somewhat skeletal, but the IRS has provided more detail regarding what type of organization qualifies for this exemption in the regulations, specifically at Reg. §1.501(c)(6)-1 which provides:

> A business league is an association of persons having some common business interest, the purpose of which is to promote such common interest and not to engage in a regular business of a kind ordinarily carried on for profit. It is an organization of the same general class as a chamber of commerce or board of trade. Thus, its activities should be directed to the improvement of business conditions of one or more lines of business as distinguished from the performance of particular services for individual persons. An organization whose purpose is to engage in a regular business of a kind ordinarily carried on for profit, even though the business is conducted on a cooperative basis or produces only sufficient income to be self-sustaining, is not a business league. An association engaged in furnishing information to prospective investors, to enable them to make sound investments, is not a business league, since its activities do not further any common business interest, even though all of its income is devoted to the purpose stated. A stock or commodity exchange is not a business league, a chamber of commerce, or a board of trade within the meaning of section 501(c)(6) and is not exempt from tax. Organizations otherwise exempt from tax under this section are taxable upon their unrelated business taxable income. See part II (section 511 and following), subchapter F, chapter 1 of the Code, and the regulations thereunder.

In its letter denying exempt status the IRS cited the following to justify its position that this organization's purpose was too narrow to meet the above definition:

- Revenue Ruling 58-394 which found that an association of licensed dealers in a certain type of patented product. In that ruling, "[t]he association in this ruling owned the controlling interest in the corporation that held the basic patent of the product, it engaged mainly in furthering the business interests of its member dealers, and it did not benefit businesses that manufactured competing product of the same type covered by the patent."
- Revenue Ruling 68-182, where the IRS announced it would not follow the Seventh Circuit's decision in the case of *Pepsi-Cola Bottler's Association, Inc. v. United States*. In that ruling the IRS stated "[i]t is the position of the Service that organizations promoting a single brand or product within a line of business do not qualify for exemption under Section 501(c)(6) of the Code."
- Revenue Ruling 68-338 that "an organization that was formed to promote the interests of a particular retail trade and is not exempt from federal income tax under Section 501(c)(6) of the Code because it advises its members in the operation of their individual businesses and sells supplies and equipment to them."
- *National Muffler Dealers Association, Inc. v. United States*, 440 U.S. 472, Ct. D. 1997, 1979-1 C.B. 198 (1979) which "held that an organization of muffler dealers franchised by Midas International Corporation did not qualify for exemption from federal income tax as a business league under Section 501(c)(6) of the Code. The organization's purpose was too narrow to satisfy the line of business test of Treasury Regulation Section 1.501(c)(6)-1."

The IRS in this case found that the organization operated similarly to those described in the above citations, finding that the organization's "activities are not directed to the improvement of business conditions of one or more lines of business" and the organization was "formed to provide particular services to your members." Thus, the IRS ruled it was not an organization described in Reg. §1.501(c)(6)-1.

The organization replied that they had plans to enroll businesses that were not N franchisees. But the IRS was not impressed, finding:

> You have not explained how you educate and help franchisees with convenience store policies. You have not proven that you have access to the business policies of stores other than those of N in order to be in a position to educate and help.
>
> You have not demonstrated how you communicate and find resolutions between various convenience store owners and their respective franchisor executives.
>
> You have not provided evidence that you present and communicate unresolved and disputed issues of non-N franchisees to national non-N franchisor groups.
>
> You have not provided convincing evidence that you represent the interests of convenience store franchisees owners industry-wide apart from N franchisee owners; therefore, you are not an organization described in Section 501(c)(6) of the Code.

SECTION: 3401
EARLY RELEASE COPY OF 2017 PERCENTAGE METHOD TABLES FOR WITHHOLDING PUBLISHED

Citation: Notice 1036, 12/5/16

The IRS has issued the early release copies of the 2017 percentage method tables for income tax withholding in Notice 1036.

The tables are to be used to compute the taxes to be withheld from wages paid in 2017 by employers using the percentage method tables. They will eventually be published in Circular E for 2017.

Notice 1036

(Rev. December 2016)

Department of the Treasury
Internal Revenue Service

Early Release Copies of the 2017 Percentage Method Tables for Income Tax Withholding

Future Developments

For the latest information about developments related to Notice 1036, such as legislation enacted after it was published, go to *www.irs.gov/notice1036*.

Percentage Method Tables for Income Tax Withholding

Attached are early release copies of the Percentage Method Tables for Income Tax Withholding that will appear in Pub. 15, Employer's Tax Guide (For use in 2017). Pub. 15 will be posted on IRS.gov in December 2016.

The wage amounts shown in the Percentage Method Tables for Income Tax Withholding are net wages after the deduction for total withholding allowances. The withholding allowance amounts by payroll period have changed. For 2017, they are:

Payroll Period	One Withholding Allowance
Weekly	$ 77.90
Biweekly	155.80
Semimonthly	168.80
Monthly	337.50
Quarterly	1,012.50
Semiannually	2,025.00
Annually	4,050.00
Daily or Miscellaneous (each day of the payroll period)	15.60

When employers use the Percentage Method Tables for Income Tax Withholding, the tax for the pay period may be rounded to the nearest dollar. If rounding is used, it must be used consistently. Withheld tax amounts should be rounded to the nearest dollar by dropping amounts under 50 cents and increasing amounts from 50 to 99 cents to the next higher dollar. For example, $2.30 becomes $2 and $2.50 becomes $3.

Withholding Adjustment for Nonresident Aliens

For 2017, apply the procedure discussed below to figure the amount of income tax to withhold from the wages of nonresident alien employees performing services within the United States.

Note. Nonresident alien students from India and business apprentices from India aren't subject to this procedure.

Instructions. To figure how much income tax to withhold from the wages paid to a nonresident alien employee performing services in the United States, use the following steps.

Step 1. Add to the wages paid to the nonresident alien employee for the payroll period the amount shown in the chart below for the applicable payroll period.

Amount to Add to Nonresident Alien Employee's Wages for Calculating Income Tax Withholding Only

Payroll Period	Add Additional
Weekly	$ 44.20
Biweekly	88.50
Semimonthly	95.80
Monthly	191.70
Quarterly	575.00
Semiannually	1,150.00
Annually	2,300.00
Daily or Miscellaneous (each day of the payroll period)	8.80

Step 2. Use the amount figured in *Step 1* and the number of withholding allowances claimed (generally limited to one allowance) to figure income tax withholding. Determine the value of withholding allowances by multiplying the number of withholding allowances claimed by the appropriate amount in the table shown earlier. Reduce the amount figured in *Step 1* by the value of withholding allowances and use that reduced amount to determine the wages subject to income tax withholding. Figure the income tax withholding using the Percentage Method Tables for Income Tax Withholding provided on pages 3 and 4. Alternatively, you can figure the income tax withholding using the Wage Bracket Method Tables for Income Tax Withholding included in Pub. 15 (For use in 2017).

IRS.gov Catalog No. 21974B

Percentage Method Tables for Income Tax Withholding

(For Wages Paid in 2017)

TABLE 1—WEEKLY Payroll Period

(a) SINGLE person (including head of household)—

If the amount of wages (after subtracting withholding allowances) is: Not over $44 . . . . . The amount of income tax to withhold is: $0

Over—	But not over—		of excess over—
$44	—$224 . .	$0.00 plus 10%	—$44
$224	—$774 . .	$18.00 plus 15%	—$224
$774	—$1,812 . .	$100.50 plus 25%	—$774
$1,812	—$3,730 . .	$360.00 plus 28%	—$1,812
$3,730	—$8,058 . .	$897.04 plus 33%	—$3,730
$8,058	—$8,090 . .	$2,325.28 plus 35%	—$8,058
$8,090		$2,336.48 plus 39.6%	—$8,090

(b) MARRIED person—

If the amount of wages (after subtracting withholding allowances) is: Not over $166 . . . . . The amount of income tax to withhold is: $0

Over—	But not over—		of excess over—
$166	—$525 . .	$0.00 plus 10%	—$166
$525	—$1,626 . .	$35.90 plus 15%	—$525
$1,626	—$3,111 . .	$201.05 plus 25%	—$1,626
$3,111	—$4,654 . .	$572.30 plus 28%	—$3,111
$4,654	—$8,180 . .	$1,004.34 plus 33%	—$4,654
$8,180	—$9,218 . .	$2,167.92 plus 35%	—$8,180
$9,218		$2,531.22 plus 39.6%	—$9,218

TABLE 2—BIWEEKLY Payroll Period

(a) SINGLE person (including head of household)—

If the amount of wages (after subtracting withholding allowances) is: Not over $88 . . . . . The amount of income tax to withhold is: $0

Over—	But not over—		of excess over—
$88	—$447 . .	$0.00 plus 10%	—$88
$447	—$1,548 . .	$35.90 plus 15%	—$447
$1,548	—$3,623 . .	$201.05 plus 25%	—$1,548
$3,623	—$7,460 . .	$719.80 plus 28%	—$3,623
$7,460	—$16,115 . .	$1,794.16 plus 33%	—$7,460
$16,115	—$16,181 . .	$4,650.31 plus 35%	—$16,115
$16,181		$4,673.41 plus 39.6%	—$16,181

(b) MARRIED person—

If the amount of wages (after subtracting withholding allowances) is: Not over $333 . . . . . The amount of income tax to withhold is: $0

Over—	But not over—		of excess over—
$333	—$1,050 . .	$0.00 plus 10%	—$333
$1,050	—$3,252 . .	$71.70 plus 15%	—$1,050
$3,252	—$6,221 . .	$402.00 plus 25%	—$3,252
$6,221	—$9,308 . .	$1,144.25 plus 28%	—$6,221
$9,308	—$16,360 . .	$2,008.61 plus 33%	—$9,308
$16,360	—$18,437 . .	$4,335.77 plus 35%	—$16,360
$18,437		$5,062.72 plus 39.6%	—$18,437

TABLE 3—SEMIMONTHLY Payroll Period

(a) SINGLE person (including head of household)—

If the amount of wages (after subtracting withholding allowances) is: Not over $96 . . . . . The amount of income tax to withhold is: $0

Over—	But not over—		of excess over—
$96	—$484 . .	$0.00 plus 10%	—$96
$484	—$1,677 . .	$38.80 plus 15%	—$484
$1,677	—$3,925 . .	$217.75 plus 25%	—$1,677
$3,925	—$8,081 . .	$779.75 plus 28%	—$3,925
$8,081	—$17,458 . .	$1,943.43 plus 33%	—$8,081
$17,458	—$17,529 . .	$5,037.84 plus 35%	—$17,458
$17,529		$5,062.69 plus 39.6%	—$17,529

(b) MARRIED person—

If the amount of wages (after subtracting withholding allowances) is: Not over $360 . . . . . The amount of income tax to withhold is: $0

Over—	But not over—		of excess over—
$360	—$1,138 . .	$0.00 plus 10%	—$360
$1,138	—$3,523 . .	$77.80 plus 15%	—$1,138
$3,523	—$6,740 . .	$435.55 plus 25%	—$3,523
$6,740	—$10,083 . .	$1,239.80 plus 28%	—$6,740
$10,083	—$17,723 . .	$2,175.84 plus 33%	—$10,083
$17,723	—$19,973 . .	$4,697.04 plus 35%	—$17,723
$19,973		$5,484.54 plus 39.6%	—$19,973

TABLE 4—MONTHLY Payroll Period

(a) SINGLE person (including head of household)—

If the amount of wages (after subtracting withholding allowances) is: Not over $192 . . . . . The amount of income tax to withhold is: $0

Over—	But not over—		of excess over—
$192	—$969 . .	$0.00 plus 10%	—$192
$969	—$3,354 . .	$77.70 plus 15%	—$969
$3,354	—$7,850 . .	$435.45 plus 25%	—$3,354
$7,850	—$16,163 . .	$1,559.45 plus 28%	—$7,850
$16,163	—$34,917 . .	$3,887.09 plus 33%	—$16,163
$34,917	—$35,058 . .	$10,075.91 plus 35%	—$34,917
$35,058		$10,125.26 plus 39.6%	—$35,058

(b) MARRIED person—

If the amount of wages (after subtracting withholding allowances) is: Not over $721 . . . . . The amount of income tax to withhold is: $0

Over—	But not over—		of excess over—
$721	—$2,275 . .	$0.00 plus 10%	—$721
$2,275	—$7,046 . .	$155.40 plus 15%	—$2,275
$7,046	—$13,479 . .	$871.05 plus 25%	—$7,046
$13,479	—$20,167 . .	$2,479.30 plus 28%	—$13,479
$20,167	—$35,446 . .	$4,351.94 plus 33%	—$20,167
$35,446	—$39,946 . .	$9,394.01 plus 35%	—$35,446
$39,946		$10,969.01 plus 39.6%	—$39,946

IRS.gov Catalog No. 21974B

Percentage Method Tables for Income Tax Withholding (continued)

(For Wages Paid in 2017)

TABLE 5—QUARTERLY Payroll Period

(a) SINGLE person (including head of household)—

If the amount of wages (after subtracting withholding allowances) is: Not over $575 . . . . . The amount of income tax to withhold is: $0

Over—	But not over—		of excess over—
$575	—$2,906 . .	$0.00 plus 10%	—$575
$2,906	—$10,063 . .	$233.10 plus 15%	—$2,906
$10,063	—$23,550 . .	$1,306.65 plus 25%	—$10,063
$23,550	—$48,488 . .	$4,678.40 plus 28%	—$23,550
$48,488	—$104,750 . .	$11,661.04 plus 33%	—$48,488
$104,750	—$105,175 . .	$30,227.50 plus 35%	—$104,750
$105,175		$30,376.25 plus 39.6%	—$105,175

(b) MARRIED person—

If the amount of wages (after subtracting withholding allowances) is: Not over $2,163 . . . . . The amount of income tax to withhold is: $0

Over—	But not over—		of excess over—
$2,163	—$6,825 . .	$0.00 plus 10%	—$2,163
$6,825	—$21,138 . .	$466.20 plus 15%	—$6,825
$21,138	—$40,438 . .	$2,613.15 plus 25%	—$21,138
$40,438	—$60,500 . .	$7,438.15 plus 28%	—$40,438
$60,500	—$106,338 . .	$13,055.51 plus 33%	—$60,500
$106,338	—$119,838 . .	$28,182.05 plus 35%	—$106,338
$119,838		$32,907.05 plus 39.6%	—$119,838

TABLE 6—SEMIANNUAL Payroll Period

(a) SINGLE person (including head of household)—

If the amount of wages (after subtracting withholding allowances) is: Not over $1,150 . . . . . The amount of income tax to withhold is: $0

Over—	But not over—		of excess over—
$1,150	—$5,813 . .	$0.00 plus 10%	—$1,150
$5,813	—$20,125 . .	$466.30 plus 15%	—$5,813
$20,125	—$47,100 . .	$2,613.10 plus 25%	—$20,125
$47,100	—$96,975 . .	$9,356.85 plus 28%	—$47,100
$96,975	—$209,500 . .	$23,321.85 plus 33%	—$96,975
$209,500	—$210,350 . .	$60,455.10 plus 35%	—$209,500
$210,350		$60,752.60 plus 39.6%	—$210,350

(b) MARRIED person—

If the amount of wages (after subtracting withholding allowances) is: Not over $4,325 . . . . . The amount of income tax to withhold is: $0

Over—	But not over—		of excess over—
$4,325	—$13,650 . .	$0.00 plus 10%	—$4,325
$13,650	—$42,275 . .	$932.50 plus 15%	—$13,650
$42,275	—$80,875 . .	$5,226.25 plus 25%	—$42,275
$80,875	—$121,000 . .	$14,876.25 plus 28%	—$80,875
$121,000	—$212,675 . .	$26,111.25 plus 33%	—$121,000
$212,675	—$239,675 . .	$56,364.00 plus 35%	—$212,675
$239,675		$65,814.00 plus 39.6%	—$239,675

TABLE 7—ANNUAL Payroll Period

(a) SINGLE person (including head of household)—

If the amount of wages (after subtracting withholding allowances) is: Not over $2,300 . . . . . The amount of income tax to withhold is: $0

Over—	But not over—		of excess over—
$2,300	—$11,625 . .	$0.00 plus 10%	—$2,300
$11,625	—$40,250 . .	$932.50 plus 15%	—$11,625
$40,250	—$94,200 . .	$5,226.25 plus 25%	—$40,250
$94,200	—$193,950 . .	$18,713.75 plus 28%	—$94,200
$193,950	—$419,000 . .	$46,643.75 plus 33%	—$193,950
$419,000	—$420,700 . .	$120,910.25 plus 35%	—$419,000
$420,700		$121,505.25 plus 39.6%	—$420,700

(b) MARRIED person—

If the amount of wages (after subtracting withholding allowances) is: Not over $8,650 . . . . . The amount of income tax to withhold is: $0

Over—	But not over—		of excess over—
$8,650	—$27,300 . .	$0.00 plus 10%	—$8,650
$27,300	—$84,550 . .	$1,865.00 plus 15%	—$27,300
$84,550	—$161,750 . .	$10,452.50 plus 25%	—$84,550
$161,750	—$242,000 . .	$29,752.50 plus 28%	—$161,750
$242,000	—$425,350 . .	$52,222.50 plus 33%	—$242,000
$425,350	—$479,350 . .	$112,728.00 plus 35%	—$425,350
$479,350		$131,628.00 plus 39.6%	—$479,350

TABLE 8—DAILY or MISCELLANEOUS Payroll Period

(a) SINGLE person (including head of household)—

If the amount of wages (after subtracting withholding allowances) divided by the number of days in the payroll period is: Not over $8.80 . . . . . The amount of income tax to withhold per day is: $0

Over—	But not over—		of excess over—
$8.80	—$44.70 . .	$0.00 plus 10%	—$8.80
$44.70	—$154.80 . .	$3.59 plus 15%	—$44.70
$154.80	—$362.30 . .	$20.11 plus 25%	—$154.80
$362.30	—$746.00 . .	$71.99 plus 28%	—$362.30
$746.00	—$1,611.50 . .	$179.43 plus 33%	—$746.00
$1,611.50	—$1,618.10 . .	$465.05 plus 35%	—$1,611.50
$1,618.10		$467.36 plus 39.6%	—$1,618.10

(b) MARRIED person—

If the amount of wages (after subtracting withholding allowances) divided by the number of days in the payroll period is: Not over $33.30 . . . . . The amount of income tax to withhold per day is: $0

Over—	But not over—		of excess over—
$33.30	—$105.00 . .	$0.00 plus 10%	—$33.30
$105.00	—$325.20 . .	$7.17 plus 15%	—$105.00
$325.20	—$622.10 . .	$40.20 plus 25%	—$325.20
$622.10	—$930.80 . .	$114.43 plus 28%	—$622.10
$930.80	—$1,636.00 . .	$200.87 plus 33%	—$930.80
$1,636.00	—$1,843.70 . .	$433.59 plus 35%	—$1,636.00
$1,843.70		$506.29 plus 39.6%	—$1,843.70

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SECTION: 4980D
EXEMPTION FOR CERTAIN SMALL BUSINESS HRA PASSED BY CONGRESS

Citation: 21st Century Cures Act, HR 34, 12/7/16

The U.S. Senate has approved the 21st Century Cures Act, agreeing to the House amendments to the Act. The bill contains, among numerous other provisions, a provision (Act Section 18001) that will exempt certain small business health reimbursement arrangements (HRAs), including those reimbursing private insurance premiums, from the $100 per day penalty for a non-compliant group health plan provided by adding a new exception to IRC §9831. The President has announced that he will sign the bill.

In Notice 2013-54 the IRS held that an employer that reimburses individual insurance policies would generally be found to have a group health plan that failed to comply with the requirements of the Affordable Care Act. Under IRC §4980D an employer operating a non-compliant plan would be subject to a $100 penalty per day per affected employee for the period the plan was operated.

Congress has now passed a bill that would exempt certain small employers from this provision, allowing the employer to reimburse private plan premiums of their employees. But the plan would need to meet certain conditions.

A program that meets the exemption requirements is described as a "Qualified Small Employer Health Reimbursement Arrangement." [IRC §9831(d)(2)] Such a program must be offered on the same terms to all eligible employees of the eligible employer. As well the program must meet the following requirements:

- The arrangement is funded solely by an eligible employer and no salary reduction contributions may be made under such arrangement,
- The arrangement provides, after the employee provides proof of coverage, for the payment of, or reimbursement of, an eligible employee for expenses for medical care (as defined in section IRC §213(d)) incurred by the eligible employee or the eligible employee's family members (as determined under the terms of the arrangement), and
- The amount of payments and reimbursements described in clause (ii) for any year do not exceed $4,950 ($10,000 in the case of an arrangement that also provides for payments or reimbursements for family members of the employee).

Certain insurance related variations will not cause the arrangement to be deemed to be offered on different terms to the various employees. Specifically, IRC §9831(d)(2)(C) provides:

> (C) CERTAIN VARIATION PERMITTED. -- For purposes of subparagraph (A)(ii), an arrangement shall not fail to be treated as provided on the same terms to each eligible employee merely because the employee's permitted benefit under such arrangement varies in accordance with the variation in the price of an insurance policy in the relevant individual health insurance market based on --
>
> > (i) the age of the eligible employee (and, in the case of an arrangement which covers medical expenses of the eligible employee's family members, the age of such family members), or
> >
> > (ii) the number of family members of the eligible employee the medical expenses of which are covered under such arrangement.
>
> The variation permitted under the preceding sentence shall be determined by reference to the same insurance policy with respect to all eligible employees.

The dollar limits provided above must be prorated based on the number of months an individual is covered under the arrangement for any employee not covered for the entire year. The dollar limits will also be adjusted for inflation in $50 increments for years beginning after 2016.

"Eligible employees" would have the same meaning (and exclusions) as provided for self-insured medical reimbursement arrangements found in IRC §105(h)(3)(B) except instead of a three year waiting period there would be only a ninety day period. Thus such programs could exclude:

- Employees who have not completed 90 days of service;
- employees who have not attained age 25;
- part-time or seasonal employees;
- employees not included in the plan who are included in a unit of employees covered by an agreement between employee representatives and one or more employers which the IRS finds to be a collective bargaining agreement, if accident and health benefits were the subject of good faith bargaining between such employee representatives and such employer or employers; and
- employees who are nonresident aliens and who receive no earned income from the employer which constitutes income from sources within the United States.

Part time and seasonal employees for this purpose are defined by Reg. §1.105-11(c)(2)(iii)(C) as follows:

> Part-time employees whose customary weekly employment is less than 35 hours, if other employees in similar work with the same employer (or, if no employees of the employer are in similar work, in similar work in the same industry and location) have substantially more hours, and seasonal employees whose customary annual employment is less than 9 months, if other employees in similar work with the same employer (or, if no employees of the employer are in similar work, in similar work in the same industry and location) have substantially more months. Notwithstanding the preceding sentence, any employee whose customary weekly employment is less than 25 hours or any employee whose customary annual employment is less than 7 months may be considered as a part-time or seasonal employee.

To be an employer eligible to offer this program the employer cannot be an applicable large employer under the ACA (as defined at IRC §4980H(c)(2)) and the employer cannot offer a group health plan to any of its employees.

Employees must be covered under minimum essential coverage for a month in order for any amounts received under the program to be excludable from income. [IRC §106(g)] The employee also will not be eligible for a health insurance credit for any month the employee is covered under the arrangement so long as the arrangement provides "affordable coverage." [IRC §36B(c)]

The arrangement shall be treated as providing affordable coverage if:

- the excess of --
  - the amount that would be paid by the employee as the premium for such month for self-only coverage under the second lowest cost silver plan offered in the relevant individual health insurance market, over
  - 1/12 of the employee's permitted benefit (as defined in section 9831(d)(3)(C)) under such arrangement, does not exceed --
- 1/12 of 9.5 percent of the employee's household income.

The employer is required to give the employee notice under this program within 90 days of the beginning of the tax year or from the date the employee shall be eligible to participate in the program. The notice must contain the following:

- A statement of the amount which would be such eligible employee's permitted benefit under the arrangement for the year.

- A statement that the eligible employee should provide the information described above to any health insurance exchange to which the employee applies for advance payment of the premium assistance tax credit.
- A statement that if the employee is not covered under minimum essential coverage for any month the employee may be subject to tax under section 5000A for such month and reimbursements under the arrangement may be includible in gross income." [IRC §9831(d)(4)]

If an employer fails to give the required notice, a penalty of $50 per employee per incident (with a maximum penalty of $2,500 per calendar year) applies unless the employer can show the failure is due to reasonable cause and not willful neglect. [IRC §6652(o)]

The new rule is effective for tax years beginning after December 31, 2016. The relief provided in Treasury Notice 2015-17 will be treated as applying to any plan year beginning on or before December 31, 2016. Presumably this means the $100 penalty will not apply (that is, the June 30, 2015 date for the end of relief would not apply), but the law is not entirely clear on that point.