Chapter 2: Affordable Care Act Update

Corrections were made to this workbook through January of 2014. No subsequent modifications were made.

Substantial proposed regulations have been issued by the Treasury Department in connection with various aspects of healthcare reform over the course of late 2012 and the first part of 2013. At the time this book was published, there was still significant uncertainty with regard to the application of several areas of the law that will require further guidance and clarification.

Moreover, the Department of Health and Human Services (HHS) has also issued proposed rules that must work in conjunction with the rules that the Treasury Department has proposed. Both the Treasury Department and HHS released substantial guidance on February 1, 2013. Throughout 2013, administrative procedures, forms, and lines of communication between governmental agencies continue to be developed.

Although this chapter refers to the recent regulations issued by the Treasury Department and HHS as "proposed," much of this guidance is subject to change and may become final by the time this book is published.

Because it is impractical to cover all areas of the proposed regulations, this chapter focuses on the proposed regulations that are most relevant to the tax practitioner. Proposed guidance in the following four key areas is covered in this chapter.

- The 3.8% net investment income tax (effective January 1, 2013)
- The 0.9% additional Medicare tax (effective January 1, 2013)
- The individual mandate to maintain healthcare coverage (effective January 1, 2014)
- The employer mandate for healthcare coverage (effective January 1, 2014, with enforcement delayed until January 1, 2015[1])

1. IRS Notice 2013-45, 2013-31 IRB 116.

NET INVESTMENT INCOME TAX

The following acronyms are used in this section.

- ACB — Adjusted cost basis
- AGI — Adjusted gross income
- FEIE — Foreign earned income exclusion
- FMV — Fair market value
- MAGI — Modified adjusted gross income
- MFS — Married filing separately
- NII — Net investment income
- NIIT — Net investment income tax
- SE — Self employment
- SPP — Significant participation passive

The Health Care and Education Reconciliation Act of 2010[2] created chapter 2A of the Code, which presently consists of only one section: IRC §1411. Under §1411, effective January 1, 2013, a new Medicare tax — the "net investment income tax" (NIIT) — applies to certain types of income received by the taxpayer. In order to understand the scope of the NIIT, it is necessary to have a working knowledge of several definitions and concepts, including the following.

- The types of taxpayers subject to this tax
- The definition of "net investment income" to which this tax applies
- The important exceptions to the application of this tax

On December 5, 2012, proposed regulations[3] were released that provide additional details and guidance regarding many of the key definitions and concepts that define the scope of this new tax.

The proposed regulations indicate that some terms used within §1411 are those that are customary within the area of federal taxation and are construed or defined in accordance with their common meanings. Other terms, however, have been defined in the proposed regulations in a manner designed to promote fair administration of this tax and prevent circumvention of its application.[4]

TAXPAYERS AFFECTED

The 3.8% NIIT applies to three types of taxpayers.[5]

- Individuals
- Trusts
- Estates

2. PL 111-152 (Mar. 30, 2010).
3. REG 130507-11, Federal Register, Vol. 77, No. 234.
4. See Preamble, REG 130507-11, Federal Register, Vol. 77, No. 234.
5. Ibid.

Individual Taxpayers

For purposes of the NIIT, an "individual" generally refers to any **natural person.**

IRC §1411(a)(1) states that the 3.8% NIIT applies to the **lesser of:**

- The taxpayer's **net investment income** (NII) for the year, **or**
- The amount of **modified adjusted gross income** in excess of the taxpayer's **threshold amount.**

Modified adjusted gross income (MAGI) is defined as adjusted gross income (AGI) without regard to the impact of the foreign earned income exclusion (FEIE) or the amount of deductions or exclusions that might otherwise be claimed for the FEIE.[6] The customary definition of AGI is adopted as defined in IRC §62; this is the amount that is shown on the 2013 **Form 1040, line 37.**

The taxpayer's **threshold amount** depends upon the individual taxpayer's filing status, as follows.

Filing Status	Threshold Amount
Married Filing Jointly (MFJ), Qualifying Widow(er) (QW)	$250,000
Married Filing Separately (MFS)	125,000
Single (S), Head of Household (HoH)	200,000

> **Observation.** The threshold amounts are **not indexed for inflation** under current tax law.

Example 1. Miguel is a single individual with a 2013 MAGI of $150,000, which includes NII of $40,000.

I. NII for the year		$40,000
II. MAGI in excess of threshold:		
MAGI	$150,000	
Less: applicable threshold for filing status	(200,000)	
MAGI in excess of threshold	$ 0	$ 0
Lesser of I or II:		$ 0

Because the lesser of I or II is $0, the 3.8% NIIT does not affect Miguel for the 2013 tax year.

Example 2. Use the same facts as **Example 1,** except Miguel has 2013 MAGI of $210,000, which includes $20,000 of interest income reported on line 8a of Form 1040 and $20,000 of dividend income reported on line 9a.

I. Net investment income for the year		$40,000
II. MAGI in excess of threshold:		
MAGI	$210,000	
Less: applicable threshold for filing status	(200,000)	
MAGI in excess of threshold	$ 10,000	$10,000
Lesser of I or II:		$10,000

6. IRC §1411(d).

Of the $40,000 of NII received by Miguel during 2013, the $10,000 of NII that is over the $200,000 threshold amount is subject to the 3.8% NIIT. The additional tax liability Miguel has as a result of the NIIT is $380 ($10,000 × 3.8%). This is reported on Form 8960, *Net Investment Income Tax — Individuals, Estates, and Trusts,* as follows.

Form **8960**

Department of the Treasury
Internal Revenue Service (99)

Net Investment Income Tax— Individuals, Estates, and Trusts

▶ Attach to Form 1040 or Form 1041.

▶ Information about Form 8960 and its separate instructions is at *www.irs.gov/form8960.*

OMB No. XXXX-XXXX

2013

Attachment Sequence No. 72

Name(s) shown on Form 1040 or Form 1041	Your social security number or EIN
Miguel	777-77-7777

Part I Investment Income ☐ Section 6013(g) election (see instructions) ☐ Regulations section 1.1411-10(g) election (see instructions)

1	Taxable interest (Form 1040, line 8a; or Form 1041, line 1)			1	20,000
2	Ordinary dividends (Form 1040, line 9a; or Form 1041, line 2a)			2	20,000
3	Annuities from nonqualified plans (see instructions)			3	
4a	Rental real estate, royalties, partnerships, S corporations, trusts, etc. (Form 1040, line 17; or Form 1041, line 5)	4a			
b	Adjustment for net income or loss derived in the ordinary course of a non-section 1411 trade or business (see instructions)	4b			
c	Combine lines 4a and 4b			4c	
5a	Net gain or loss from disposition of property from Form 1040, combine lines 13 and 14; or from Form 1041, combine lines 4 and 7	5a			
b	Net gain or loss from disposition of property that is not subject to net investment income tax (see instructions)	5b			
c	Adjustment from disposition of partnership interest or S corporation stock (see instructions)	5c			
d	Combine lines 5a through 5c			5d	
6	Changes to investment income for certain CFCs and PFICs (see instructions)			6	
7	Other modifications to investment income (see instructions)			7	
8	Total investment income. Combine lines 1, 2, 3, 4c, 5d, 6, and 7			8	40,000

Part II Investment Expenses Allocable to Investment Income and Modifications

9a	Investment interest expenses (see instructions)	9a			
b	State income tax (see instructions)	9b			
c	Miscellaneous investment expenses (see instructions)	9c			
d	Add lines 9a, 9b, and 9c			9d	
10	Additional modifications (see instructions)			10	
11	Total deductions and modifications. Add lines 9d and 10			11	0

Part III Tax Computation

12	Net investment income. Subtract Part II, line 11 from Part I, line 8. Individuals complete lines 13–17. Estates and trusts complete lines 18a–21. If zero or less, enter -0-			12	40,000
	Individuals:				
13	Modified adjusted gross income (see instructions)	13	210,000		
14	Threshold based on filing status (see instructions)	14	200,000		
15	Subtract line 14 from line 13. If zero or less, enter -0-	15	10,000		
16	Enter the smaller of line 12 or line 15			16	10,000
17	Net investment income tax for individuals. Multiply line 16 by 3.8% (.038). Enter here and on Form 1040, line 60			17	380
	Estates and Trusts:				
18a	Net investment income (line 12 above)	18a			
b	Deductions for distributions of net investment income and deductions under section 642(c) (see instructions)	18b			
c	Undistributed net investment income. Subtract line 18b from 18a (see instructions)	18c			
19a	Adjusted gross income (see instructions)	19a			
b	Highest tax bracket for estates and trusts for the year (see instructions)	19b			
c	Subtract line 19b from line 19a. If zero or less, enter -0-	19c			
20	Enter the smaller of line 18c or line 19c			20	
21	Net investment income tax for estates and trusts. Multiply line 20 by 3.8% (.038). Enter here and on Form 1041, Schedule G, line 4			21	

For Paperwork Reduction Act Notice, see your tax return instructions. Cat. No. 59474M Form **8960** (2013)

Example 3. Use the same facts as **Example 1,** except Miguel has 2013 MAGI of $270,000, which includes $40,000 of NII.

I. NII for the year		$40,000
II. MAGI in excess of threshold:		
MAGI	$270,000	
Less: applicable threshold for filing status	(200,000)	
MAGI in excess of threshold	$ 70,000	$70,000
Lesser of I or II:		$40,000

Even though Miguel has $70,000 of income above his applicable $200,000 threshold, the 3.8% NIIT only applies to Miguel's net investment income and not to other types of income. Because all of Miguel's net investment income exceeds his $200,000 threshold, Miguel is subject to NIIT on the entire $40,000 net investment income amount. His total NIIT liability is $1,520 ($40,000 × 3.8%).

Observation. Taxpayers with MAGI under the threshold amounts are not subject to NIIT. Taxpayers with no NII are also not subject to NIIT.

Exempt Individuals. Although the NIIT generally applies to all natural persons, it does not apply to nonresident aliens.[7] A nonresident alien is an individual who is neither a citizen nor a resident of the United States.[8]

A U.S. citizen married to a nonresident alien is generally treated as a MFS taxpayer.[9] The income of the spouse who is a U.S. citizen or resident is subject to the NIIT, and the MFS threshold of $125,000 applies to that income under the NIIT rules. The income of the nonresident alien spouse is not subject to the NIIT. However, both spouses may make a special election to file a joint return.[10] If this election is made, the nonresident alien spouse is treated as a U.S. resident for tax purposes.[11] All income on the joint return, including that of the nonresident alien spouse, is subject to the NIIT rules for a couple making this election.

Note. For more details and guidance on this joint election, see Treas. Reg. §§1.6013-6 and 1.6013-7.

7. Prop. Treas. Reg. §1.1411-2(a)(1).

8. IRC §7701(b)(1)(B).

9. IRC §6013(a)(1).

10. IRC §6013(g).

11. Treas. Reg. §1.6013-6(a)(1).

Estates and Trusts

The NIIT may affect the tax liability shown on Form 1041, *U.S. Income Tax Return for Estates and Trusts,* for an estate and trust. Although neither the Code nor the regulations provide a definition of an estate or trust, these entities are taxed under part I of Subchapter J of the Code. If the estate or trust is subject to tax under Subchapter J, then that estate or trust is also subject to the NIIT rules. Subchapter J applies to the taxable income of estates and various types of trust arrangements, including the following.[12]

- Income accumulated in trust for the benefit of unborn or unascertained person(s) with contingent interests
- Income accumulated in trust and held for future disposition
- Income to be either currently distributed to beneficiaries or income that is held by a guardian for later distribution under a court order
- Income received by a decedent's estate during the administration or settlement period of the estate
- Income that can be distributed under the discretion of the trustee

Generally, the typical, ordinary trust arrangement that is subject to Subchapter J trust tax rules is one in which property is given to one or more trustees who are responsible for the protection of the property and for managing or conserving the property for beneficiaries.[13] However, if a trust arrangement has a business purpose or has trustees and beneficiaries that use the trust arrangement for profit-making purposes, the arrangement is not considered an ordinary trust subject to Subchapter J tax rules. Instead, it is classified as a business entity under the "check-the-box" rules. Typically, such trusts are taxed as either a corporation or partnership.[14] The fact that the beneficiaries did not provide the trustee(s) with the trust property is not alone sufficient to categorize the trust as an ordinary Subchapter J trust rather than a business-purpose trust.[15] However, beneficiaries with multiple classes of ownership may be indicative of a business-purpose or investment trust.[16]

Note. For more information on whether a trust arrangement is properly classified as an ordinary trust subject to Subchapter J taxation and the NIIT or, in the alternative, is classified as a business or investment trust, see Treas. Reg. §301.7701-4.

Each year, a trust (including an estate) is liable for NIIT in the amount of 3.8% of the **lesser of:**

- The trust's **undistributed** NII for the year, **or**
- The **excess** (if any) of the trust's AGI over the dollar amount at which the highest tax bracket for estates and trusts begins **($11,950 for 2013).**[17]

Undistributed NII for the trust or estate is calculated by first determining the NII of the trust.

Note. The amount of NII for a trust or estate is generally calculated in the same way as NII for individuals. The applicable rules for determining the amount of NII for an individual, trust, or estate are discussed later in this chapter.

12. IRC §641(a).
13. Treas. Reg. §301.7701-4(a).
14. Treas. Reg. §301.7701-4(b).
15. Ibid.
16. Treas. Reg. §301.7701-4(c).
17. Rev. Proc. 2013-15, 2013-5 IRB 444.

The NII for an estate or trust is based on all the amounts of NII that the trust has **received** during the year.[18] After the amount of the estate's or trust's NII that has been received is determined, the undistributed NII is calculated using the following general formula.

Trust or estate NII

– **Amount allowed as a deduction under trust tax law for distributions of net income made to beneficiaries**[19]

– **Amount of deduction allowed under trust tax law for any amounts permanently paid or set aside for charitable contributions**[20]

Undistributed NII subject to NIIT

The NII that the trust distributes to beneficiaries retains its character as NII and forms part of the NII of each beneficiary for the tax year.[21]

Note. Trust tax rules are complex. For guidance on the amounts allowed as a deduction for distributions to beneficiaries, see IRC §651 and the underlying regulations (for simple trusts) and IRC §661 and the underlying regulations (for complex trusts and estates). A complex trust may be entitled to a deduction for amounts set aside or paid as charitable contributions under IRC §642(c). "Simple" and "complex" trusts are defined in Treas. Reg. §1.651(a)-1.

Exempt Trusts. The proposed regulations specifically exempt certain trusts from the NIIT, including the following.[22]

- A trust (or portion of a trust) that is treated by Subchapter J as a grantor trust

Note. A grantor trust is generally a trust established by a taxpayer who does not relinquish full control over the trust property. Such a trust is usually not recognized as a separate taxable entity. All grantor trust income and deductions are treated as directly belonging to the grantor. The grantor is generally subject to the NIIT instead of the grantor trust. IRC §§671–678 address grantor trusts.

- Trusts that have been established exclusively for religious, charitable, scientific, literary, or educational purposes, or to prevent cruelty to children or animals
- Trusts formed to foster national or international amateur sports (without the provision of athletic facilities or equipment)
- Trusts that are tax exempt under IRC §501 (which include trusts organized as civic leagues, social welfare organizations, chambers of commerce, or social or recreation clubs)
- Charitable remainder trusts (however, such trusts' beneficiaries are subject to the NIIT rules)
- Any other trusts, funds, or accounts that are statutorily tax exempt, such as an Archer medical savings account, a health savings account, a §529 qualified tuition program, or a Coverdell education savings account
- Foreign trusts[23]

18. Prop. Treas. Reg. §1.1411-3(e)(1).
19. Prop. Treas. Reg. §1.1411-3(e)(3)(i).
20. Prop. Treas. Reg. §1.1411-3(e)(4).
21. Prop. Treas. Reg. §1.1411-3(e)(3)(ii).
22. Prop. Treas. Reg. §1.1411-3(b).
23. Prop. Treas. Reg. §1.1411-3 suggests that there may be some exceptions to the foreign trust exemption, but the Department of the Treasury has reserved comment on any exceptions. Further guidance may be provided on this issue. Foreign trusts are defined in IRC §7701(a)(31)(B).

Other Special Trusts. The proposed regulations offer guidance on the application of the NIIT rules for the following special trusts.

Type of Trust	Further Guidance
Electing small business trust (ESBT)	Prop. Treas. Reg. §1.1411-3(c)(1)
Charitable remainder trust	Prop. Treas. Reg. §1.1411-3(c)(2)
Bankruptcy estate	Prop. Treas. Reg. §1.1411-3(d)(1)

Note. If the debtor is an individual, the bankruptcy estate is subject to NIIT rules. The applicable threshold is the same as for an MFS taxpayer ($125,000).

NET INVESTMENT INCOME

It is essential for the tax practitioner to understand how NII is calculated for individuals, trusts, and estates that are subject to the NIIT rules, because the amount of NII for the year determines:

- Whether that individual, trust, or estate will have NIIT liability for the year; and
- What the NIIT liability is, using the 3.8% rate.

NII for an individual, trust, or estate taxpayer subject to the NII rules includes some forms of **income** and **capital gains** the taxpayer receives during the year. However, not all income or capital gains become part of NII for the taxpayer. Both the **income** and **capital gain** components have some exceptions that are not subject to the 3.8% NIIT.

Generally, **NII includes** the following types of income.

1. Gross interest, dividends, annuities, royalties, rents, and substitute interest or dividends
2. Other income from a covered trade or business
3. Net capital gains attributable to the disposition of property other than property held in a trade or business[24]

Some common forms of income that are **not included** in NII include the following.

- Wages
- Unemployment benefits
- Net income from a nonpassive business
- Social security benefits
- Alimony
- Tax-exempt interest
- Self-employment income[25]
- Qualified plan distributions (IRC §§401(a), 403(a), 403(b), 408, 408A, 457(b))[26]

24. IRC §1411(c)(1)(A).
25. Prop. Treas. Reg. §1.1411-9.
26. Prop. Treas. Reg. §1.1411-8.

> **Note.** The proposed regulations indicate that the rules associated with NII will generally not become effective until the 2014 tax year. The Treasury Department and the IRS intend to finalize these regulations sometime during 2013. However, taxpayers may rely on these proposed regulations in order to comply with the NII rules for the 2013 tax year.[27]

Central to the definition of NII is the concept of a **trade or business** to which the tax applies, which is:

- A trade or business in which the taxpayer's activity is passive under IRC §469, or
- A trade or business of trading financial instruments or commodities, referred to as a **covered business.**[28]

> **Note.** IRC §469 and the underlying regulations are the same tax rules used to determine whether the taxpayer's activity constitutes **material participation** for passive loss purposes.

Business Exception

The types of income received by the taxpayer that are listed in Item 1 (gross interest, dividends, annuities, royalties, rents, and substitute interest or dividends) are **not part of the taxpayer's NII** if those types of income are derived in the **ordinary course of a trade or business** that is:

- In accordance with how "trade or business" is construed under IRC §162,
- **Not** a passive activity under §469 for the taxpayer, and
- **Not** a covered trade or business.[29]

> **Note.** Income that is not subject to the NIIT may be subject to the additional Medicare tax, which is discussed later in this chapter.

Whether the taxpayer's activity is passive is determined at the individual taxpayer level. This is in accord with §469 and the underlying regulations.

Example 4. Alexa and Buffy are partners in Dynamic Auto Interiors, a partnership. Alexa and Buffy formed the partnership with each contributing equipment and money to start the business. Buffy works full-time for the partnership and handles all aspects of its business operations.

Alexa, however, is merely an investor in the partnership. Therefore, she does not meet the 500-hour test or any of the other material participation tests set forth in Temp. Treas. Reg. §1.469-5T.

The partnership allocates $2,000 of business income to each partner in 2013. Because Buffy's full-time role in the business easily meets the 500-hour (and perhaps other) tests in Temp. Treas. Reg. §1.469-5T, the partnership business is not a passive activity for her. Buffy's $2,000 of business income is excluded in computing her net investment income for 2013. Alexa's role, however, is passive; therefore, her $2,000 of business income is included in computing her NII for 2013. If Alexa meets all the other requirements for the NIIT (such as her income exceeding the threshold for her filing status), this $2,000 may be subject to the 3.8% NIIT.

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27. See Preamble, REG 130507-11, Federal Register, Vol. 77, No. 234.
28. IRC §1411(c)(2).
29. Prop. Treas. Reg. §1.1411-4(b).

Example 5. Use the same facts as **Example 4,** except that the partnership that Alexa and Buffy form is A&B Spec and Hedge Commodities Trading. All of the partnership's business activity involves trading commodities. Because the business is a covered business, the $2,000 of business income allocated to both Alexa and Buffy is part of each partner's NII for 2013.

General Calculation Rules of Net Investment Income

General tax rules are used in the calculation of NII each year.[30] An item that is recognized as income is also recognized as NII if that income falls into one of the three categories of NII listed earlier. A deduction allowable under general tax rules is also allowed as a deduction against that income for NII purposes. These deductions include the following.

- Investment interest expense
- Investment advisory and brokerage fees
- State and local income taxes properly allocable to NII

Note. The proposed regulations indicate that the deductions that may be used to reduce NII are those deductions allowed by subtitle A of the Code.[31] If the taxpayer chooses to forgo a tax deduction, it is not clear whether the taxpayer is entitled to use that deduction to reduce NII.

Rental Income

The NII rules under §1411 depend on how §469 categorizes rental income before application of the NII rules to determine whether that rental income is subject to the 3.8% NIIT. Generally, rental income is considered passive under §469.[32] However, rental income is considered nonpassive if the taxpayer is a real estate professional.[33] A real estate professional is a taxpayer who meets both of the following tests.[34]

- More than half of the personal services performed by the taxpayer during the year involve real estate trades or businesses in which the taxpayer materially participates.
- The taxpayer spends more than 750 hours per year in real property trade or business activities in which the taxpayer materially participates.

Note. Treas. Reg. §1.469-9 contains additional guidance on real estate professionals and the §469 rules for rental income.

If the rental income is considered nonpassive under §469 **and** it is derived in a §162 trade or business, that rental income is not part of the taxpayer's NII for the year because the business exception applies. The proposed regulation states that a real estate professional is not necessarily engaged in a trade or business with regard to rental real estate activities. If the real estate activities of the real estate professional are not §162 trades or businesses, the rental income is subject to the NIIT.[35]

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30. Prop. Treas. Reg. §1.1411-1(a).
31. Prop. Treas. Reg. §1.1411-4(a)(2).
32. IRC §469(c)(2).
33. IRC §469(c)(7).
34. IRC §469(c)(7)(B); Treas. Reg. §1.469-9(c)(1).
35. See Preamble, REG 130507-11, Federal Register, Vol. 77, No. 234.

Example 6. Aretha works full time as a music producer. Her filing status is single. She owns a second home, which she rents out to a tenant. In 2013, she receives $6,000 in rental income. Her 2013 AGI is $370,000, which is composed of Aretha's self-employment income from her music production business and the $6,000 of rental income. During 2013, Aretha's rental income is considered passive income under the §469 rules. Therefore, the rental income is classified as NII for Aretha for 2013 and is subject to the 3.8% NIIT. Aretha's NIIT liability is $228 (3.8% × $6,000).

Example 7. Use the same facts as **Example 6,** except Aretha is a real estate professional. Because Aretha is a real estate professional, the rental income is nonpassive under §469 rules. Under the NII rules, if the rental income is derived in the ordinary course of a business (as "trade or business" is used under §162), then the rental income is not NII for 2013. Accordingly, the 3.8% NIIT does not apply to the $6,000 because it falls under the business exception.

Self-Rental Rule. Under the self-rental rules, rental income that would normally be considered passive is recharacterized as nonpassive.[36] This recharacterization prevents the taxpayer from using a self-rental to generate additional passive income against which unused passive losses can be applied. The proposed regulation with respect to the NIIT indicates that in most cases, self-rental income is subject to the NIIT if it is not derived in the ordinary course of a trade or business.[37] However, the treatment of self-rental income was the subject of an April 2013 IRS hearing at which the IRS received several requests to clarify certain aspects of the proposed regulations. It is anticipated that further guidance will be forthcoming to provide further details and clarification on the application of the NIIT to self-rental income.[38]

Grouping Activities under §469

Categorizing income as passive or nonpassive under §469 is necessary before applying the NII rules of §1411. Income that would otherwise be passive but that is categorized as nonpassive under §469 because of the way the taxpayer has grouped activities is not considered part of the taxpayer's NII. This is the case as long as the income is from a §162 "trade or business" that is not a covered business.

If the taxpayer engages in two or more activities in which the taxpayer's activity does not meet any of the material participation tests in Temp. Treas. Reg. §1.469-5T, those activities may be grouped and considered as a single activity that may meet one of the material participation tests. In order to be grouped, the activities must constitute an appropriate economic unit.[39]

Example 8. In addition to Dr. Everson's family medical practice, she has a public speaking business and owns a laboratory. Both are operated as sole proprietorships. She spends only 90 hours on her public speaking business during 2013.

Her lab provides test results for her patients and for patients of several other physicians. Dr. Everson spends 510 hours in 2013 on her lab business.

Because Dr. Everson does not meet the material participation requirement for her speaking business, the net income from it is generally considered passive. She meets the material participation requirement for her laboratory business.

36. IRC §469.

37. See Preamble, REG 130507-11, Federal Register, Vol. 77, No. 234.

38. The IRS held a hearing on April 2, 2013, at which several tax practitioners testified and requested clarification and simplification in various areas of the proposed regulation.

39. See Treas. Reg. §1.469-4(c).

Under the rules of §469, Dr. Everson can group the two businesses in order to meet the material participation requirement for both of them if the activities constitute an appropriate economic unit. If she elects to group the two businesses as a single activity, the net profit from the speaking business is considered nonpassive under §469. Under the §1411 NII rules, if the speaking activity is a trade or business (under §162) and is not a covered business engaged in the trading of financial instruments or commodities, the income is not considered NII for Dr. Everson for 2013. Consequently, it is not subject to the 3.8% NIIT.[40]

Note. The proposed regulation[41] indicates that the taxpayer has the ability to **regroup** activities in the first year beginning after December 31, 2013, in which they become subject to the NIIT. The same proposed regulation also refers to the ability to regroup "for any taxable year that begins during 2013" if the NIIT applies. Accordingly, although this represents a fresh opportunity to regroup activities without regard to any previous grouping, it is not clear whether authority exists for regrouping in 2013.

Passive Activity Loss Recharacterization Rules

Regulations under the passive activity loss rules of §469 have several "recharacterization rules" that serve to classify certain types of income as nonpassive that otherwise might be considered passive.[42] Income considered nonpassive under a recharacterization rule is not part of the taxpayer's NII as long as it is from a trade or business (as construed under §162) that is not a covered trade or business. This is because §469 is used within the definition of NII in determining whether income is passive and therefore part of the taxpayer's NII for the year.

One such recharacterization rule is the significant participation passive activity rule. A significant participation passive (SPP) activity is one in which the taxpayer participates for more than 100 hours during the tax year but does not materially participate under any of the seven material participation tests found in Temp. Treas. Reg. §1.469-5T.[43]

Example 9. During 2013, Ella participates in three different trade or business activities. All of these activities are a "trade or business" under §162. The following table provides a description of the type of interest, the type of activity, and other relevant data in connection with the 2013 tax year.

	S Corporation Interest	Partnership Interest	Sole Proprietorship	Totals
Description of business	Used car sales	Printing	Clothing retail	
Hours of participation during year	105	147	162	
Gross passive income	$8,000	$12,000	$4,000	$24,000
Passive activity deductions	(2,000)	(5,000)	(7,000)	(14,000)
Net passive income	$6,000	$ 7,000	($3,000)	$10,000

Because Ella's participation in each of the business activities is more than 100 hours and she does not meet any of the seven material participation tests in Temp. Treas. Reg. §1.469-5T, each of the three activities constitutes an SPP activity. Ella's total SPP activity gross income exceeds her total SPP deductions by $10,000 for the year.

Under Temp. Treas. Reg. §1.469-2T(f)(2)(i), the $10,000 of total net passive income is treated as income that is **nonpassive.** Accordingly, it is also considered nonpassive under NII rules because each of the used car, clothing retail, and printing businesses constitutes a "trade or business" under §162 and none of the businesses is a covered trade or business. Therefore, the $10,000 is excluded in computing Ella's 2013 NII.

40. Prop. Treas. Reg. §§1.1411-5(a), (b).

41. Prop. Treas. Reg. §1.469-11(b)(3)(iv), as added by REG 130507-11, Federal Register, Vol. 77, No. 234.

42. See Temp. Treas. Reg. §1.469-2T(f).

43. Temp. Treas. Reg. §1.469-2T(f)(2).

Other examples of recharacterization rules under Temp. Treas. Reg. §1.469-2T(f) include the following.

Recharacterization Rule	Guidance
Rental of nondepreciable property	Temp. Treas. Reg. §1.469-2T(f)(3)
Net interest income from passive equity-financed lending activity	Temp. Treas. Reg. §1.469-2T(f)(4)
Acquiring an interest in a pass-through entity that licenses intangible property	Temp. Treas. Reg. §1.469-2T(f)(7)

Income Attributable to Working Capital

Income or gain earned on the working capital of a business is considered NII. Working capital is generally:

- The average daily balance of the business's operating or other checking account(s), and
- Amounts set aside for which there is no current need or use.[44]

Example 10. Salvatore owns Sal's Body Shop, Inc., an S corporation. His full-time activity in the business is nonpassive under the §469 rules and the business constitutes a "trade or business" under §162.

The business checking account is maintained at the local bank. This account earns interest and the average daily balance is $4,000 in 2013.

Salvatore also keeps $50,000 in a business money market account. This serves as a "cushion" to alleviate periods of negative cash flow and to fund equipment purchases.

Both the checking and money market accounts are considered working capital. The interest earned on them is included in computing 2013 NII and is subject to the 3.8% NIIT.

S Corporation Stock and Partnership Interest Dispositions

S corporation shares and partnership interests are not considered property held in an active business. Accordingly, any gain recognized on the sale of such an interest by the taxpayer is subject to the NIIT.[45] However, the proposed regulations provide an exception to this rule for nonpassive shareholders or partners.[46] The nonpassive seller of S corporation shares or a partnership interest can exclude from NII the amount of gain that the S corporation or partnership would recognize from a sale of its assets at fair market value (FMV). This is because an S corporation's (or partnership's) gain on the sale of assets in the active business does not constitute NII for the shareholder (or partner). The shareholder (or partner) can therefore exclude the amount of the gain on the sale of shares (or partnership interest) that is attributable to an asset sale by the S corporation (or partnership). The actual amount of gain or loss recognized for NIIT purposes is found by first calculating an "adjustment amount" (explained next). Subsequently, the actual gain or loss on the sale of shares or partnership interest is increased or decreased by the adjustment amount to determine the amount of gain or loss recognized as NII.

44. Prop. Treas. Reg. §1.1411-6(b).

45. See Preamble, REG 130507-11, Federal Register, Vol. 77, No. 234.

46. Prop. Treas. Reg. §1.1411-7.

Sale of S Corporation Shares. The **adjustment amount** for the selling shareholder is calculated using the following four steps, as outlined in the proposed regulations.[47] The adjustment is made in order to determine how much of the recognized gain or loss is NII and is subject to the 3.8% NIIT.

Step 1. For purposes of calculating the adjustment amount, the S corporation is deemed to sell its assets in a fully taxable cash transaction. The deemed sale price for each asset is the FMV immediately before the taxpayer sold their S corporation shares.

Step 2. Using the FMV of each individual asset and its adjusted cost basis (ACB), determine each asset's gain or loss amount. **Each asset must be treated separately.**

Step 3. The gain or loss for each asset must be allocated to the share disposition by the shareholder in accordance with IRC §1366(a) . Generally, §1366(a) requires the allocation to be accomplished for each shareholder on a pro-rata basis in accordance with the proportional ownership interest of each shareholder who sold shares.

Step 4. Make the adjustment to the recognized gain or loss on the share disposition. Gains or losses allocable to each shareholder from the deemed asset sales are netted to arrive at an aggregate gain or loss amount. The following rules apply.

- An allocated net gain to the selling shareholder constitutes a **negative adjustment** and is used to reduce the amount of actual recognized gain from the sale of shares. Any excess of actual gain over the allocated asset gain is the amount from the sale of the shares that is NII and subject to NIIT.
- An allocated net loss constitutes a **positive adjustment** and is used to reduce the amount of recognized loss from the sale of shares. The sum of the recognized loss and the allocated net loss from the deemed asset sale is the shareholder's total gain that is NII and subject to NIIT.

Example 11. Sarah and Jeanine own Egremontaine Manufacturing and Structural Steel, Inc. (EMSS), an S corporation. Sarah owns an 80% interest and Jeanine owns the remaining 20% interest. Sarah and Jeanine have stock bases of $80,000 and $20,000, respectively. Sarah works for EMSS on a full-time basis; therefore, her role in EMSS is not passive under §469. However, Jeanine's role is as an investor and her role in EMSS is passive under the rules of §469. Both Sarah and Jeanine have AGI over the applicable threshold for their respective filing statuses and are subject to NIIT for 2013. The S corporation has the following assets.

	Adjusted Cost Basis	FMV
Land	$ 50,000	$140,000
Building	40,000	80,000
Stamping press	30,000	5,000
Plasma cutter	20,000	15,000
Total	$140,000	$240,000

During 2013, Sarah and Jeanine decide to sell their S corporation shares. They find a buyer who pays $240,000, which reflects the FMV of the corporation's assets assuming no goodwill. Because Sarah has an 80% interest, she sells her shares for $192,000 (80% × $240,000). Jeanine sells her 20% interest for $48,000 (20% × $240,000).

47. Prop. Treas. Reg. §1.1411-7(c).

Sarah recognizes a gain of $112,000 ($192,000 proceeds − $80,000 basis) and **Jeanine recognizes a gain of $28,000** ($48,000 proceeds − $20,000 basis). These gains constitute NII and are generally subject to the 3.8% NIIT. However, because Sarah's role in EMSS is not passive, her $112,000 gain is eligible for an adjustment that reduces the actual amount that is subject to the 3.8% NIIT. The adjustment is calculated using the following four steps.

Step 1. Upon a hypothetical deemed FMV sale of properties for cash, the S corporation would receive the FMV for each asset, as indicated in the preceding table, for a total of $240,000.

Step 2. Each asset's gain or loss is determined as shown in the following table.

	ACB	FMV	Gain/(Loss)
Land	$ 50,000	$140,000	$ 90,000
Building	40,000	80,000	40,000
Stamping press	30,000	5,000	(25,000)
Plasma cutter	20,000	15,000	(5,000)
Total	$140,000	$240,000	$100,000

Step 3. In accordance with §1366(a), Sarah is allocated her pro rata share (80%) of the gain or loss from each asset. The following amounts of gain are allocated to Sarah.

Asset	Gain/(Loss)	80% Allocable to Sarah
Land	$ 90,000	$72,000
Building	40,000	32,000
Stamping press	(25,000)	(20,000)
Plasma cutter	(5,000)	(4,000)
Total gain/(loss)	$100,000	$80,000

Step 4. Sarah must make an adjustment to her recognized gain to determine the amount of gain on the sale of her shares that is subject to the 3.8% NIIT. Because there is a net gain (and not a loss) on the deemed asset sale allocable to Sarah, there will be a **negative adjustment** (reduction) to her recognized gain when calculating the amount of her share sale gain that is subject to the NIIT. The negative adjustment is shown in the following table.

Recognized gain on share sale	$112,000
Negative adjustment from gain allocable from hypothetical deemed FMV sale of assets by S corporation	(80,000)
Net gain included in NII for NIIT purposes	$ 32,000

Assume the entire $32,000 of net gain is subject to the NIIT. As a result of her share disposition, Sarah's NIIT is $1,216 (3.8% × $32,000).

Because EMSS is a passive activity for Jeanine, her $28,000 gain is not subject to an adjustment. If Jeanine's MAGI exceeds the threshold and she has no other NII income or loss amounts, her 2013 NIIT liability is $1,064 (3.8% × $28,000).

Limitations on Negative and Positive Adjustments. There are limitations on the applicability of negative and positive adjustments.[48] The following table summarizes these limitations.

	Recognized Gain on Share Disposition	Recognized Loss on Share Disposition
Negative adjustment	Taken into account up to the amount of the recognized gain	Not taken into account
Positive adjustment	Not taken into account	Taken into account up to the amount of the recognized loss

A negative adjustment may be used to reduce a recognized gain to zero. A positive adjustment may be used to eliminate a recognized loss.

Example 12. Use the same facts as **Example 11,** except the physical location of EMSS was declared a hazardous waste site. Consequently, the FMV amounts for the assets are substantially below their respective ACB amounts. Sarah and Jeanine sell their shares for a total of $25,000. Sarah's share of the proceeds is $20,000 (80% × $25,000) and Jeanine's share of the proceeds is $5,000 (20% × $25,000).The following table illustrates the ACB, FMV, per-asset loss amounts, and Sarah's allocable loss amount.

	ACB	FMV	Gain/(Loss)	80% Allocable to Sarah
Land	$ 50,000	$10,000	($ 40,000)	($32,000)
Building	40,000	10,000	(30,000)	(24,000)
Stamping press	30,000	5,000	(25,000)	(20,000)
Plasma cutter	20,000	15,000	(5,000)	(4,000)
Total gain/(loss)	$140,000	$40,000	($100,000)	($80,000)

Because Sarah's share basis is $80,000 and her proceeds from the sale of the shares are $20,000, Sarah has a recognized loss of $60,000. After using the four steps outlined previously, there is an $80,000 loss allocable to Sarah to be used in adjusting her recognized loss on the sale of her shares. Because there is a net **loss** on the deemed asset sale that is allocable to Sarah, a positive adjustment (increase) is made to her recognized loss when calculating the amount of her share sale gain, if any, that is subject to the NIIT. The positive adjustment is shown in the following table.

Recognized loss on share sale	($60,000)
Positive adjustment from loss allocable from hypothetical deemed FMV sale of assets by S corporation ($80,000 positive adjustment limited to the amount of the $60,000 recognized loss)	60,000
Net gain/loss included in NII for NIIT purposes	$ 0

Sarah's recognized loss of $60,000 is reduced by a positive adjustment of $60,000, resulting in a zero loss that is included in NII for NIIT purposes. Accordingly, Sarah is not able to include a loss in her NII amount for the 2013 tax year.

48. Prop. Treas. Reg. §§1.1411-7(c)(5)(iii), (iv).

Jeanine has a $15,000 recognized loss on the sale of her shares ($20,000 share basis − $5,000 proceeds). Because Jeanine is a passive participant in EMSS under §469, her $15,000 of recognized loss is not subject to any positive adjustment. Jeanine incurs no NIIT liability on her loss amount. If she had other property dispositions for the year that resulted in gains to be included in NII, this $15,000 loss could be netted against those gains to reduce her NII (and resulting NIIT liability) for the year.[49]

Note. The above example indicates Jeanine's calculations for NIIT liability purposes, but she still has to determine if there are any income tax effects from her share sale. In addition, before a taxpayer sells S corporation shares, proper documentation regarding the FMV of the S corporation's assets, including any necessary appraisals, must be obtained.

Sale of Partnership Interests. Gains or losses that are includible in a taxpayer's NII for the year are subject to the same rules as those applicable to a disposition of S corporation shares.[50] Allocation of the gain or loss on the deemed FMV sale of partnership assets must be made in accordance with IRC §§704(b) and 704(c), with appropriate adjustments to basis under §743.[51]

Multiple Business Activities. An S corporation or partnership may hold some assets that are not used within a trade or business activity. In addition, the S corporation or partnership may engage in multiple activities. The shareholder or partner may be nonpassive in some of those activities and passive in others. When calculating the adjustment amount, only gain or loss on assets used in a trade or business is taken into account.[52] If an asset is used in both the nonpassive and passive activities of the S corporation or partnership, the gain or loss used for purposes of calculating the adjustment amount is the portion attributable to the percentage of time the asset was used in the nonpassive business activity.[53]

Sale of Goodwill. If there is a sale of goodwill for a business involved in nonpassive and passive activities, only the amount of goodwill attributable to the nonpassive business is taken into account for purposes of calculating the adjustment amount. The amount of goodwill attributable to the nonpassive activities of the business is found by apportioning goodwill between nonpassive and passive activities based on the relative FMV of the assets (other than cash) that are used in each of the nonpassive and passive business categories.[54]

Observation. Although assets and goodwill used in both nonpassive and passive activities are prorated according to the time used or relative asset FMV for each type of activity respectively, the proposed regulation offers no guidance on the particular recordkeeping that is necessary to document either the time an asset is used within an activity or the FMV of assets attributable to an activity.

49. Prop. Treas. Reg. §1.1411-4(d)(3).
50. Prop. Treas. Reg. §1.1411-7(a).
51. Prop. Treas. Reg. §1.1411-7(c)(4).
52. Prop. Treas. Reg. §1.1411-7(e), Example 5.
53. Prop. Treas. Reg. §1.1411-7(e), Example 7.
54. Prop. Treas. Reg. §1.1411-7(e), Example 8.

Required Statement. A taxpayer who sells S corporation shares or a partnership interest and who makes an adjustment to the recognized gain or loss for NII purposes must file a statement with the tax return for the year of sale.[55] The statement filed must include the following details.

- The taxpayer's name and the identification number of the S corporation or partnership in which an interest was sold
- A description of the interest sold
- The cost basis and FMV of each asset within the S corporation or partnership
- The taxpayer's allocable share of gain or loss for each item of the S corporation or partnership property
- Details about whether the assets were held in a trade or business that was nonpassive or passive, or whether the assets were held in a covered business
- The amount of net gain includible in the taxpayer's NII for the year
- The calculation of the adjustment amount for the taxpayer for the disposition of the S corporation or partnership interest

Self-Employment Income

NII for the year does not include any net business income subject to self-employment (SE) tax.[56]

> **Note.** It is not possible for the taxpayer to receive income that is subject to **both** the SE tax and the NIIT. However, income subject to the SE tax may also be subject to the additional Medicare tax of 0.9% if the taxpayer's income is high enough to trigger this additional tax. The additional Medicare tax is discussed later in this chapter.

Other types of income that the Code specifically excludes from SE income may be part of the taxpayer's NII and subject to the NIIT. Among the types of income the Code specifically excludes from SE income are the following.

- Certain types of real estate net rental income, including rental income from personal property leased with real estate[57]
- Dividends and interest[58]
- A limited partner's distributive share (other than a guaranteed payment for services rendered)[59]
- Gains or losses from the sale or exchange of capital assets[60]

55. Prop. Treas. Reg. §1.1411-7(d).
56. IRC §1411(c)(6); Prop. Treas. Reg. §1.1411-9(a).
57. IRC §1402(a)(1).
58. IRC §1402(a)(2).
59. IRC §1402(a)(13).
60. IRC §1402(a)(3).

These types of income that are excluded from SE income by the Code are subject to NIIT if they meet the definition of NII (discussed earlier in this chapter) and if the taxpayer's income exceeds the applicable NIIT threshold for the year.

Note. IRC §1402(a)(3)(A) states that gains or losses from the sale of capital assets are **not** included in SE net earnings and are therefore **not** subject to SE tax. IRC §1411(c)(6) states that NII does not include amounts that are subject to SE tax. These two provisions are important in determining what amounts received by a self-employed taxpayer are subject to the NIIT rules.

Example 13. Sharon is an engineer and a **general partner** in Continental Partners, LLP (CP). CP completes major construction projects worldwide. For 2013, Sharon's distributive share from CP is $800,000. Of this $800,000, $200,000 is capital gain from the sale of land. The remaining $600,000 of Sharon's distributions constitutes SE income for the year and is subject to SE tax.

IRC §1402(a)(3)(A) excludes the $200,000 capital gain from SE earnings and SE tax. However, for 2013, assuming all other requirements for the NII are satisfied, the $200,000 capital gain constitutes NII for Sharon. If Sharon's MAGI exceeds the applicable threshold for her filing status, she will have NIIT liability on the $200,000 capital gain.

Self-Employed Traders. Income from a trade or business engaged in trading financial instruments or commodities is a **covered business** subject to the NIIT rules. [61] **For tax purposes, a taxpayer who purchases and sells securities is categorized as either a trader, dealer, or investor.**

The definition of **trader** is not provided anywhere in the Code or regulations but has been formed through case law. The definition of trader can be summarized as someone who engages in the following activities.

- Trades a large volume of transactions on a regular basis but has no customers[62]
- Purchases and sells securities frequently to take advantage of daily market movements for short-term profits[63]
- Obtains profits through direct management of buying and selling[64]
- Focuses on short-term trading instead of holding investments long-term, and income is derived principally from the sale of securities instead of from receipt of dividends or interest from the securities[65]

In contrast, a **dealer** is generally a taxpayer who regularly buys securities for (or sells securities to) customers or offers to engage in various securities transactions with customers. An **investor** is a taxpayer who buys or sells securities for the principal purpose of obtaining investment income and gains by retaining the investments over a relatively long period of time.[66]

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61. IRC §1411(c)(2)(B).
62. *Marlowe King v. Comm'r*, 89 TC No. 445 (Sep. 9, 1987); *R.P. Groetzinger v. Comm'r*, 771 F.2d 269 (7th Cir. 1985), *aff'd* 107 S.Ct. 980 (1987).
63. *C. H. Laing v. Comm'r*, 23 TC No. 1040 (Mar. 18, 1955).
64. *R. E. Purvis v. Comm'r,* 65 TC 1165 (Mar. 30, 1976); *aff'd per curiam* 530 F.2d 1332 (9th Cir. 1976).
65. Ibid.
66. See Preamble, REG 130507-11, Federal Register, Vol. 77, No. 234.

Generally, because a trader's gross income from trading is **not** subject to SE tax,[67] that gross income **is** subject to the NIIT rules.[68] Because the trader's expenses are not used to reduce SE income, those expenses may be used to reduce the gross income to determine the net amount that is subject to the NIIT.[69] This is true even if the trader makes a "mark-to-market" election under IRC §475(f).

Example 14. Grant uses his S corporation to engage in the trade or business of trading stocks and bonds. Grant's activity with stocks and bonds qualifies him as a trader. A business engaged in trading financial securities or commodities is covered by IRC §1411(c)(2)(B).

For 2013, Grant has $600,000 of gross income from trading and $200,000 of expenses attributable to the trading business. As a trader, Grant's gross income of $600,000 is not subject to SE tax;[70] therefore, it does not fall under the exception to NII provided by IRC §1411(c)(6) and is part of his NII for 2013. Grant's $200,000 of expenses can be used to reduce his gross income of $600,000. The net amount of $400,000 is subject to the NIIT.

Note. A dealer is generally a covered business under IRC §1411(c)(2)(B) and is therefore subject to the NIIT. An investor's passive income is also generally subject to the NIIT.

Expenses

NII is gross investment income less the following types of expenses,[71] to the extent that these expenses are allocable to gross investment income items.

- Investment interest expense
- Investment advisory fees
- Brokerage fees
- Rental expenses
- Royalty expenses
- State and local income taxes

The limits on itemized deductions, such as the 2%-of-AGI floor, apply to amounts deducted to arrive at NII.[72]

67. IRC §1402(a)(3)(A). See also the instructions to Schedule D, *Capital Gains and Losses.*
68. IRC §1411(c)(6).
69. Prop. Treas. Reg. §1.1411-9(b).
70. IRC §1402(a)(3)(A). See also the instructions to Schedule D, *Capital Gains and Losses.*
71. Prop. Treas. Reg. §1.1411-4(f).
72. Prop. Treas. Reg. §1.1411-4(f)(3).

Example 15. Stan and Linda are Illinois residents who file jointly for 2013. They itemize their deductions on Schedule A. Both are age 70, retired, and had the following income in 2013.

Interest income	$ 26,500 [a]
Tax-exempt interest (nontaxable for federal tax purposes)	57,100
Ordinary dividends	12,400 [a]
Net capital gain from sale of securities (reported on line 13, Form 1040)	83,600 [a]
IRA distributions	46,300
Pension income	110,000
Net rental real estate income (farmland rental)	8,000 [a]
Taxable social security income	21,200
Total 2013 income	$365,100

[a] These items represent investment income for Form 8960 purposes. The other income items do not represent investment income and are omitted when completing Form 8960.

Stan and Linda's 2013 AGI shown on their Form 1040 is $308,000 ($365,100 – $57,100 of tax-exempt interest).

Their Illinois base income shown on their 2013 Form IL-1040, *Individual Income Tax Return,* is $187,600, which is calculated as follows.

Federal AGI reported on their 2013 Form 1040	$308,000
Plus: tax-exempt interest	57,100
Less: IRA distributions	(46,300)
Less: pension income	(110,000)
Less: taxable social security income	(21,200)
2013 Form IL-1040 base income	$187,600

Stan and Linda's 2013 Illinois state income tax deduction on Schedule A is $9,075, of which $6,316 is attributable to investment income reported in Part l of their 2013 Form 8960. The amount of Stan and Linda's Illinois base income attributable to investment income is calculated as follows.

2013 Form IL-1040 base income	$187,600
Less: tax-exempt interest	(57,100)
Balance of 2013 Form IL-1040 base income	$130,500

The portion of the $9,075 total 2013 Illinois state income tax attributable to investment income reported on Stan and Linda's 2013 Form 8960 is expressed in the following fraction:

$$\textbf{State income tax attributable to investment income} = \frac{\$130{,}500}{\$187{,}600} \times \$9{,}075$$
$$= 69.6\% \times \$9{,}075$$
$$= \$6{,}316$$

Stan and Linda's 2013 Form 8960 is shown next.

For Example 15

Form **8960**

Department of the Treasury
Internal Revenue Service (99)

Net Investment Income Tax— Individuals, Estates, and Trusts

▶ Attach to Form 1040 or Form 1041.
▶ Information about Form 8960 and its separate instructions is at *www.irs.gov/form8960.*

OMB No. XXXX-XXXX
2013
Attachment Sequence No. **72**

Name(s) shown on Form 1040 or Form 1041: **Stan and Linda Smith**
Your social security number or EIN: **111-22-3333**

Part I Investment Income ☐ Section 6013(g) election (see instructions)
☐ Regulations section 1.1411-10(g) election (see instructions)

1	Taxable interest (Form 1040, line 8a; or Form 1041, line 1)			1	26,500
2	Ordinary dividends (Form 1040, line 9a; or Form 1041, line 2a)			2	12,400
3	Annuities from nonqualified plans (see instructions)			3	
4a	Rental real estate, royalties, partnerships, S corporations, trusts, etc. (Form 1040, line 17; or Form 1041, line 5)	4a	8,000		
b	Adjustment for net income or loss derived in the ordinary course of a non-section 1411 trade or business (see instructions)	4b	0		
c	Combine lines 4a and 4b			4c	8,000
5a	Net gain or loss from disposition of property from Form 1040, combine lines 13 and 14; or from Form 1041, combine lines 4 and 7	5a	83,600		
b	Net gain or loss from disposition of property that is not subject to net investment income tax (see instructions)	5b			
c	Adjustment from disposition of partnership interest or S corporation stock (see instructions)	5c			
d	Combine lines 5a through 5c			5d	83,600
6	Changes to investment income for certain CFCs and PFICs (see instructions)			6	
7	Other modifications to investment income (see instructions)			7	
8	Total investment income. Combine lines 1, 2, 3, 4c, 5d, 6, and 7			8	130,500

Part II Investment Expenses Allocable to Investment Income and Modifications

9a	Investment interest expenses (see instructions)	9a			
b	State income tax (see instructions)	9b	6,316		
c	Miscellaneous investment expenses (see instructions)	9c			
d	Add lines 9a, 9b, and 9c			9d	6,316
10	Additional modifications (see instructions)			10	
11	Total deductions and modifications. Add lines 9d and 10			11	6,316

Part III Tax Computation

12	Net investment income. Subtract Part II, line 11 from Part I, line 8. Individuals complete lines 13–17. Estates and trusts complete lines 18a–21. If zero or less, enter -0-			12	124,184
	Individuals:				
13	Modified adjusted gross income (see instructions)	13	308,000		
14	Threshold based on filing status (see instructions)	14	250,000		
15	Subtract line 14 from line 13. If zero or less, enter -0-	15	58,000		
16	Enter the smaller of line 12 or line 15			16	58,000
17	Net investment income tax for individuals. Multiply line 16 by 3.8% (.038). Enter here and on Form 1040, line 60			17	2,204
	Estates and Trusts:				
18a	Net investment income (line 12 above)	18a			
b	Deductions for distributions of net investment income and deductions under section 642(c) (see instructions)	18b			
c	Undistributed net investment income. Subtract line 18b from 18a (see instructions)	18c			
19a	Adjusted gross income (see instructions)	19a			
b	Highest tax bracket for estates and trusts for the year (see instructions)	19b			
c	Subtract line 19b from line 19a. If zero or less, enter -0-	19c			
20	Enter the smaller of line 18c or line 19c			20	
21	Net investment income tax for estates and trusts. Multiply line 20 by 3.8% (.038). Enter here and on Form 1041, Schedule G, line 4			21	

For Paperwork Reduction Act Notice, see your tax return instructions. Cat. No. 59474M Form **8960** (2013)

Observations for Stan and Linda's 2013 Form 8960.

1. Their $57,100 of tax-exempt interest is not investment income. Therefore, it is not subject to the 3.8% NIIT.
2. Their $6,316 of state income tax shown on line 9b of Form 8960 did not affect the computation of their $2,204 of NIIT. This is because their MAGI minus the threshold amount is $58,000 (line 15) which is less than their NII of $124,184 (line 12).

Caution. Example 15 was written without the benefit of the 2013 Form 8960 instructions, which had not been published when this book went to press.

THE ADDITIONAL MEDICARE TAX

The following acronyms are used in this section.

- ACA — Affordable Care Act
- AGI — Adjusted gross income
- ATRA — American Taxpayer Relief Act
- FICA — Federal Insurance Contributions Act
- HoH — Head of household
- MAGI — Modified adjustable gross income
- MFJ — Married filing jointly
- MFS — Married filing separately
- NII — Net investment income
- NIIT — Net investment income tax
- QW — Qualifying widow(er)
- RRTA — Railroad Retirement Tax Act
- SE — Self employment

The Affordable Care Act (ACA) added §3101(b)(2) to the Code. This new Code section requires the payment of a 0.9% tax, called the additional Medicare tax, which is an entirely separate tax from the 3.8% NIIT discussed in the previous section.

Note. According to Jordan Tuzynski, IRS Chief of Employment Tax Policy, this tax is estimated to raise $130 billion during the first 10-year period.

It is important for the tax practitioner to know the following key aspects of the additional Medicare tax.

- Which taxpayers are subject to the tax
- The types of income subject to the tax
- How the tax is calculated and paid

TAXPAYERS AFFECTED

Taxpayers with wages and/or SE income **above a certain threshold** are subject to the additional Medicare tax. These **threshold amounts** are as follows.

Filing Status	Threshold Amount
MFJ	$250,000
MFS	125,000
S, HoH, QW	200,000

> **Note.** These threshold amounts are the same as the MAGI threshold amounts for application of the 3.8% NIIT discussed in the previous section. They are not indexed for inflation.

Taxpayers with wage or SE income amounts below these thresholds are not subject to the 0.9% additional Medicare tax for 2013 and subsequent tax years.

Corporations, estates, and trusts are not subject to the additional Medicare tax.[73]

TYPES OF INCOME AFFECTED

Two types of income are subject to the additional Medicare tax for taxpayers who exceed the threshold amount for their filing status.

- Wages and other compensation from employment
- SE income[74]

Wages and Other Compensation

For 2013, the following rates apply to wages under the Federal Insurance Contributions Act (FICA).

	Employer Portion	Employee Portion	Total
Social security	6.2%	6.2%	12.4%
Medicare	1.45%	1.45%	2.9%
Total	7.65%	7.65%	15.3%

> **Note.** Although the social security portion of FICA applies only to the first $113,700 of wages for 2013, there is no upper limit on the wage amount to which the Medicare tax applies.

73. IRC §3101(b)(2).

74. IRC §§3101(b)(2) and 1401(b)(2).

Effective for 2013 and subsequent tax years, wage and other compensation amounts in excess of the taxpayer's threshold amount that are subject to the Medicare tax are also subject to the 0.9% additional Medicare tax.[75] In addition to wages, other compensation that is subject to the Medicare tax includes the following.

- Tips and gratuities (unless under $20 for the month)
- Commission compensation
- Bonuses
- Reimbursements of business expenses to employees under a nonaccountable plan
- Back pay awards[76]
- Severance or termination pay
- Dismissal pay
- FMV of all noncash remuneration, including fringe benefits

Note. The 6th Circuit Court of Appeals recently clarified an ambiguity in the definition of "wages" and ruled that "supplemental unemployment insurance" payments do not constitute wages and are not subject to FICA. The court specifically indicated that the arguments posed by the IRS and past IRS rulings on this subject were contrary to Congressional intent.[77]

Only wage and other compensation amounts that are subject to Medicare tax are used to determine whether a taxpayer exceeds the applicable threshold amount.[78]

Other types of compensation that **are not** subject to the Medicare tax, and therefore not subject to the additional Medicare tax, include the following.

- Accident and health insurance premiums paid under a plan for employees and their dependents
- Distributions to general or limited partners
- Employer contributions to a qualified plan
- Distributions from a qualified plan
- Distributions to an officer or shareholder of an S corporation (above that amount required to meet the reasonable compensation requirement)
- Household work, agricultural labor, and services not in the course of the employer's trade or business

These other types of compensation that are not subject to the Medicare tax are not used to determine whether a taxpayer exceeds the applicable threshold amount.

Note. For additional guidance on other types of compensation to which the Medicare tax and the additional Medicare tax apply and those that are exempt, see IRS Pub. 15, *(Circular E), Employer's Tax Guide.*

75. IRC §3101(b)(2).

76. *U.S. v. Cleveland Indians Baseball Company*, 532 U.S. 200 (2001).

77. *U.S. v. Quality Stores, Inc., et al.*, 693 F.3d 605 (6th Cir. 2012).

78. REG-130074-11, 2012-52 IRB 790.

Example 16. Rudy is employed as an engineer with Core Construction Consultants, Inc. Rudy is single and he has the following income for 2013.

Wages from employment	$180,000
Interest income	30,000
Total income	$210,000

All of Rudy's wages are subject to the 1.45% Medicare tax, which was withheld by his employer. However, because Rudy's wage amount of $180,000 is below his threshold of $200,000 for a single individual, none of Rudy's 2013 wage income is subject to the 0.9% additional Medicare tax.

Note. In the preceding example, $10,000 of Rudy's interest income is subject to the 3.8% NIIT because Rudy's MAGI is over the $200,000 threshold for NIIT purposes. The rules for the NIIT are discussed in the previous section.

Example 17. Use the same facts as **Example 16,** except Rudy's income for 2013 is as follows.

Wages from employment	$240,000
Interest income	30,000
Total income	$270,000

Rudy's wages subject to the Medicare tax ($240,000) exceed his applicable threshold ($200,000) by $40,000. This $40,000 of wages in excess of the threshold is subject to the additional Medicare tax. Rudy's 2013 additional Medicare tax liability is $360 ($40,000 × 0.9%).

Note. In the preceding example, Rudy's $30,000 of interest income is subject to the 3.8% NIIT. He has an additional NIIT liability of $1,140 ($30,000 × 3.8%) for 2013 in addition to the $360 of additional Medicare tax liability.

Example 18. Use the same facts as **Example 17,** except Rudy contributes $17,500 to his §401(k) plan at work. Because the elective deferral to the §401(k) plan is considered wages for Medicare tax purposes, Rudy still has the same additional Medicare tax liability on his wages despite the §401(k) contribution for 2013.

Example 19. Use the same facts as **Example 17,** except Rudy contributes $2,500 to a §125 cafeteria plan. Because this contribution reduces his taxable Medicare wages, this amount reduces his additional Medicare tax liability by $22.50 ($2,500 × 0.9%).

Self-Employment Income

Taxpayers with income subject to SE tax may also be subject to liability for the additional Medicare tax if their SE income exceeds their applicable threshold wage amount for the year.

Self-employed taxpayers who have SE tax liability may deduct half of their SE tax in calculating their AGI.[79] However, self-employed taxpayers who have SE income that exceeds their applicable threshold and have additional Medicare tax liability for the year receive no similar deduction for purposes of calculating the additional Medicare tax.[80]

79. IRC §164(f).

80. IRC §1402(a)(12).

Taxpayers with Wage and SE Income

A special coordination rule exists for taxpayers who have both wage income and SE income. The taxpayer's applicable threshold is reduced (but not below zero) by their wage amount first. The reduced threshold is then applied to the taxpayer's SE income to determine whether there is any additional Medicare tax liability.[81]

Example 20. Corissa is a single filer. For 2013, Corissa has $160,000 of SE income from operating her own veterinary clinic. She also is employed at her local university where she teaches and conducts research. She receives $180,000 of income from the university.

Corissa's applicable threshold is $200,000 for additional Medicare tax purposes. Her $180,000 wage is below the $200,000 threshold and therefore her wages do not trigger any additional Medicare tax liability. However, her applicable $200,000 threshold is reduced by her wage amount before being applied to her SE income. Her reduced threshold is $20,000 ($200,000 − $180,000). Therefore, $140,000 of Corissa's SE income ($160,000 SE income − $20,000 reduced threshold) is subject to the additional Medicare tax. Her additional Medicare tax liability is $1,260 ($140,000 × 0.9%).

Corissa's additional Medicare tax is reported on Form 8959, which is shown on the following page.

> **Observation.** If Corissa paid a $10,000 premium for her self-employed health insurance plan in 2013, her 2013 additional Medicare tax liability would still be $1,260. This is because the self-employed health insurance deduction, which is shown on the 2013 Form 1040, line 29, is not an allowable deduction for SE tax purposes.

81. Prop. Treas. Reg. §1.1401-1(d)(2).

For Example 20

Form **8959** Department of the Treasury Internal Revenue Service

Additional Medicare Tax

▶ If any line does not apply to you, leave it blank. See separate instructions.
▶ Attach to Form 1040, 1040NR, 1040-PR, or 1040-SS.
▶ Information about Form 8959 and its instructions is at *www.irs.gov/form8959*.

OMB No. 1545-XXXX
2013
Attachment Sequence No. 71

Name(s) shown on Form 1040: Corissa
Your social security number: 666-66-6666

Part I Additional Medicare Tax on Medicare Wages

1	Medicare wages and tips from Form W-2, box 5. If you have more than one Form W-2, enter the total of the amounts from box 5	1	180,000		
2	Unreported tips from Form 4137, line 6	2			
3	Wages from Form 8919, line 6	3			
4	Add lines 1 through 3	4	180,000		
5	Enter the following amount for your filing status: Married filing jointly $250,000; Married filing separately $125,000; Single, Head of household, or Qualifying widow(er) $200,000	5	200,000		
6	Subtract line 5 from line 4. If the result is zero or less, enter -0-			6	0
7	Additional Medicare Tax on Medicare wages. Multiply line 6 by 0.9% (.009). Enter here and go to Part II			7	0

Part II Additional Medicare Tax on Self-Employment Income

8	Self-employment income from Schedule SE (Form 1040), Section A, line 4, or Section B, line 6. If you had a loss, enter -0- (Form 1040-PR and Form 1040-SS filers, see instructions.)	8	160,000		
9	Enter the following amount for your filing status: Married filing jointly $250,000; Married filing separately $125,000; Single, Head of household, or Qualifying widow(er) $200,000	9	200,000		
10	Enter the amount from line 4	10	180,000		
11	Subtract line 10 from line 9. If zero or less, enter -0-	11	20,000		
12	Subtract line 11 from line 8. If the result is zero or less, enter -0-			12	140,000
13	Additional Medicare Tax on self-employment income. Multiply line 12 by 0.9% (.009). Enter here and go to Part III			13	1,260

Part III Additional Medicare Tax on Railroad Retirement Tax Act (RRTA) Compensation

14	Railroad retirement (RRTA) compensation and tips from Form(s) W-2, box 14 (see instructions)	14			
15	Enter the following amount for your filing status: Married filing jointly $250,000; Married filing separately $125,000; Single, Head of household, or Qualifying widow(er) $200,000	15			
16	Subtract line 15 from line 14. If zero or less, enter -0-			16	
17	Additional Medicare Tax on railroad retirement (RRTA) compensation. Multiply line 16 by 0.9% (.009). Enter here and go to Part IV			17	0

Part IV Total Additional Medicare Tax

18	Add lines 7, 13, and 17. Also include this amount on Form 1040, line 60, (Form 1040NR, 1040-PR, and 1040-SS filers, see instructions) and go to Part V	18	1,260

Part V Withholding Reconciliation

19	Medicare tax withheld from Form W-2, box 6. If you have more than one Form W-2, enter the total of the amounts from box 6	19			
20	Enter the amount from line 1	20			
21	Multiply line 20 by 1.45% (.0145). This is your regular Medicare tax withholding on Medicare wages	21			
22	Subtract line 21 from line 19. This is your Additional Medicare Tax withholding on Medicare wages			22	
23	Additional Medicare Tax withholding on railroad retirement (RRTA) compensation from Form W-2, box 14			23	
24	**Total Additional Medicare Tax withholding.** Add lines 22 and 23. Also include this amount with federal income tax withholding on Form 1040, line 62 (Form 1040NR, 1040-PR, and 1040-SS filers, see instructions)			24	

For Paperwork Reduction Act Notice, see your tax return instructions. Cat. No. 59475X Form **8959** (2013)

Example 21. Gordon and Agnes file jointly for 2013. Gordon, a self-employed attorney, has $160,000 of SE income. Agnes is employed as an airline pilot instructor with a major airline and receives $180,000 of wages for the year. Because Gordon and Agnes file jointly, their applicable threshold is $250,000. Their $250,000 threshold is reduced by Agnes' $180,000 wage amount. The reduced threshold is $70,000 ($250,000 − $180,000). Of Gordon's $160,000 SE income, $90,000 ($160,000 SE income − $70,000 reduced threshold) is subject to the additional Medicare tax. Gordon and Agnes have additional Medicare tax liability of $810 ($90,000 × 0.9%).

Note. Lowering earned income by contributing to pretax plans (whether or not it saves the 0.9% additional Medicare tax), lowers AGI for purposes of computing the 3.8% NIIT.

Employment Income Subject to Railroad Retirement Tax Act

Income subject to the Railroad Retirement Tax Act (RRTA) that exceeds the taxpayer's applicable threshold is also subject to the 0.9% additional Medicare tax.[82] The taxpayer's threshold amount applies separately to Medicare wages and to RRTA wages. Therefore, Medicare wages and RRTA wages are not combined for purposes of determining whether the additional Medicare tax applies.[83] Similarly, the taxpayer's threshold applies separately to SE income and to RRTA wages. The coordination rule for wage and SE income discussed in the previous section does not apply when the taxpayer has RRTA income.

Example 22. Use the same facts as **Example 20,** except that Corissa is an engineer who specializes in railroad technology and has $160,000 of RRTA income in addition to her wage income from the local university. The university employment income is subject to Medicare tax. Corissa's $160,000 of RRTA income is not subject to the additional Medicare tax because it is below her $200,000 threshold. Moreover, her $180,000 of wage income from the university is not subject to the additional Medicare tax because it is also below her $200,000 applicable threshold. Corissa has no additional Medicare tax liability for 2013.

Example 23. Use the same facts as **Example 21,** except that Agnes is a railroad logistics supervisor with a major railway company and her income is subject to RRTA contributions. Gordon's SE income of $160,000 is below the applicable joint filer threshold of $250,000 and is therefore not subject to the additional Medicare tax. Similarly, Agnes' RRTA wage income of $180,000 is below the $250,000 applicable joint filer threshold and is also not subject to the additional Medicare tax.

PAYING AND COLLECTING THE TAXES

Taxpayers may be required to pay a portion of their tax liability during the tax year in the form of estimated payments. Estimated payments are made using Form 1040-ES, *Estimated Tax for Individuals.* A penalty is imposed on individuals who do not pay enough tax during the year either through withholding or estimated taxes.[84] To avoid the penalty, the individual must generally make four estimated tax installments/payments based upon annual tax liability. Generally, the penalty may be avoided if the taxpayer pays the lesser of the following amounts during the tax year in which the tax liability arises.

- 90% of the tax shown on the current year's return
- 100% of the tax shown on the previous year's return (110% for taxpayers with an AGI of more than $150,000 or in excess of $75,000 for MFS taxpayers)[85]

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82. IRC §3201(a); IRC §3211(a).

83. Prop. Treas. Reg. §1.1401-1(d)(2).

84. IRC §6654.

85. IRC §6654(d)(1).

Ensuring that a sufficient amount of tax is paid for the year constitutes a "safe harbor," under which no penalty for failure to pay estimated taxes will be assessed. Failure to pay at least the lesser of the above amounts of tax for the year results in a penalty if there is a balance owed on the taxpayer's return of $1,000 or more.

> **Note.** For a thorough explanation of the rules applicable to estimated taxes, see the 2013 *University of Illinois Federal Tax Workbook,* Volume C, Chapter 4: Estimated Taxes.

Changes Affecting Estimated Tax Payments for 2013 Onward

Estimated taxes are paid to cover an anticipated tax liability on types of income that are not subject to any form of tax withholding during the year. Such types of income typically include the following.

- Interest and dividends
- Rents and royalties
- Capital gains from the sale of assets

These are the same types of income that are included in the definition of NII and are therefore subject to the NIIT.[86] NII is subject to the rules for estimated taxes.[87] For 2013 onward, taxpayers (especially higher-income taxpayers) must pay increased attention to the safe harbors available to avoid estimated tax penalties. The NIIT combined with several changes effective for 2013 onward from the American Taxpayer Relief Act of 2012[88] (ATRA) make taxpayers more vulnerable to estimated tax penalties. The ATRA changes include the following.

- A new top tax bracket of 39.6%
- A higher capital gains tax rate of 20%
- The return of the phaseout of personal and dependency exemptions
- The return of the Pease limitation on itemized deductions

> **Note.** For more information about ATRA, see the 2013 *University of Illinois Federal Tax Workbook,* Volume A, Chapter 1: New Legislation.

In addition, another change affecting the potential liability for estimated tax payments is the 0.9% additional Medicare tax payable on wages and SE income. Although there are no provisions for tax withholding in connection with income or transactions that trigger the NIIT, the IRS has provided specific guidance about withholding rules for the additional Medicare tax. These rules are discussed in the next section.

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86. IRC §1411(c)(1).

87. IRC §6654(a), (f).

88. PL 112-240.

Employer Withholding and the Additional Medicare Tax

2

Any tax liability for the additional Medicare tax is paid by the taxpayer. There is no corresponding amount owed by an employer and no "employer portion" to be matched by a taxpayer with SE income.[89] However, the ACA created IRC §3102(f), which requires an employer to make certain withholdings in connection with employee wages paid.

An employer must withhold an additional 0.9% of all wages paid to an employee that exceed $200,000.[90] This $200,000 threshold must be used by the employer regardless of what the employee's actual applicable threshold is based on their filing status under the additional Medicare tax rules.[91] The employer disregards any wages paid to the employee's spouse and also disregards wages paid to the employee by another unrelated employer for whom the employee works.[92]

Example 24. Lyndon and Marge file jointly each year. Marge has no income, and Lyndon works as an executive for Metro Machine & Press Ltd. Lyndon's 2013 wages are $240,000. His employer is obligated to withhold the additional Medicare tax of 0.9% on all wages above the $200,000 withholding threshold. Because Lyndon has $40,000 of wages in excess of the $200,000 withholding threshold, his employer must withhold additional Medicare tax of $360 ($40,000 × 0.9%). The employer must withhold this amount even though $250,000 is Lyndon and Marge's applicable threshold for the additional Medicare tax because they file jointly.

It may be possible for the taxpayer to be liable for additional Medicare tax under circumstances in which the employer is not obligated to withhold any additional Medicare tax.[93] This occurs when the amount of the taxpayer's income that is subject to the additional Medicare tax exceeds the applicable threshold for their filing status but the income from one or more employers is less than the $200,000 withholding threshold.

Example 25. Orazio and Donatella file jointly each year. For 2013, Orazio receives employment wages of $150,000. Donatella receives 2013 employment wages of $190,000. Because each spouse's wages are below the $200,000 withholding threshold, neither spouse's employer is obligated to withhold any additional Medicare tax. However, Orazio and Donatella have combined wage income of $340,000 ($150,000 + $190,000), which exceeds their $250,000 threshold for additional Medicare tax purposes. Because they have $90,000 of income over their applicable threshold ($340,000 − $250,000), Orazio and Donatella have 2013 additional Medicare tax liability of $810 ($90,000 × 0.9%).

Example 26. Doug is a single taxpayer and is a geologist who is a faculty member of a natural sciences department at his local university. For 2013, his employment wages from the university are $180,000. He also operates his own consulting business and advises energy companies about natural gas extraction, which is Doug's area of expertise. His 2013 net earnings subject to SE tax are $60,000.

Because Doug's university wages are below $200,000, the university did not withhold any additional Medicare tax from his pay. Doug's applicable threshold for additional Medicare tax liability is $200,000 as a single filer. Doug's combined wage and SE income is $240,000 ($180,000 + $60,000). Of this, $40,000 is subject to the additional Medicare tax. Doug's 2013 additional Medicare tax liability is $360 ($40,000 × 0.9%).

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89. See Preamble, REG-130074-11, 2012-52 IRB 790.
90. IRC §3102(f)(1).
91. Prop. Treas. Reg. §31.3102-4(a).
92. Ibid.
93. Prop. Treas. Reg. §31.3102-4(b).

Employer Liability and Method Used for Withholding. If the employer does not withhold a sufficient amount of additional Medicare tax for an employee, the employee is primarily liable for the tax.[94] However, the employer is liable for the tax until the employee pays it.[95] The IRS will not collect the tax from the employer if the employee pays the tax, but the employer remains liable for any applicable penalties because of the failure to withhold the correct amount.[96]

The amount of uncollected tax that the employee owes for the tax year is shown on Form 1040, *U.S. Individual Income Tax Return.*[97] In addition, employers must withhold and show amounts for the additional Medicare tax on Form 941, *Employer's Quarterly Federal Tax Return.* For 2013, this form has been updated and the additional Medicare tax is reported as a separate line item (line 5d), as shown below.

Form **941 for 2013: Employer's QUARTERLY Federal Tax Return** 950113
(Rev. January 2013) Department of the Treasury — Internal Revenue Service OMB No. 1545-0029

Employer identification number (EIN) ☐☐ – ☐☐☐☐☐☐☐

Name *(not your trade name)*

Trade name *(if any)*

Address
Number Street Suite or room number
City State ZIP code

Report for this Quarter of 2013
(Check one.)
☐ **1:** January, February, March
☐ **2:** April, May, June
☐ **3:** July, August, September
☐ **4:** October, November, December
Instructions and prior year forms are available at *www.irs.gov/form941.*

Read the separate instructions before you complete Form 941. Type or print within the boxes.

Part 1: Answer these questions for this quarter.

1 Number of employees who received wages, tips, or other compensation for the pay period including: *Mar. 12* (Quarter 1), *June 12* (Quarter 2), *Sept. 12* (Quarter 3), or *Dec. 12* (Quarter 4) . . . **1**

2 Wages, tips, and other compensation . . . **2** .

3 Income tax withheld from wages, tips, and other compensation . . . **3** .

4 If no wages, tips, and other compensation are subject to social security or Medicare tax ☐ **Check and go to line 6.**

		Column 1		Column 2
5a	Taxable social security wages	.	× .124 =	.
5b	Taxable social security tips	.	× .124 =	.
5c	Taxable Medicare wages & tips	.	× .029 =	.
5d	Taxable wages & tips subject to Additional Medicare Tax withholding	.	× .009 =	.

5e Add Column 2 from lines 5a, 5b, 5c, and 5d . . . **5e** .

Note. Prop. Treas. Reg. §31.6205-1(b)(2) provides guidance on how an employer may correct the amount of additional Medicare tax withheld if an error is made.

94. Prop. Treas. Reg. §31.3202-1(g)(2).
95. Prop. Treas. Reg. §31.3102-4(c).
96. Prop. Treas. Reg. §§31.3102-4(c) and 31.3202-1(g)(3).
97. Prop. Treas. Reg. §31.6011(a)-1(h).

INDIVIDUAL MANDATE

The following acronyms are used in this section.

- HCSM — Healthcare sharing ministry
- HHS — Health and Human Services Department
- MAGI — Modified adjusted gross income
- MEC — Minimum essential coverage
- PAC — Premium assistance credit

Effective January 1, 2014, an individual must either maintain minimum essential coverage (MEC) for their own health care or pay a shared responsibility payment (penalty) on their current year's tax return.[98] Some individuals are **exempt** from this individual mandate to maintain MEC. Following is a summary of the applicable exemptions.

- Members of a recognized religious sect[99]
- Members of a healthcare sharing ministry[100]
- Individuals who are not U.S. citizens or nationals or legal aliens[101]
- Incarcerated individuals[102]
- Individuals lacking access to affordable MEC[103]
- Individuals with household income less than their filing threshold amount[104]
- Members of certain Indian tribes[105]
- Individuals without MEC during a continuous period of less than three months[106]
- Individuals determined by the state exchange to have suffered hardship that prevented them from obtaining coverage[107]

> **Note.** For further details on some basic aspects of the individual mandate and the preceding exemptions, see the 2012 *University of Illinois Federal Tax Workbook,* Volume A, Chapter 7: Healthcare Reform Act. Further guidance on these exemptions can also be found in Prop. Treas. Reg. §1.5000A-3.

On February 1, 2013, both the Treasury Department and HHS issued proposed rules to clarify certain aspects of the individual mandate. The clarified issues that are most relevant to tax practitioners are described in the following sections.

98. IRC §5000A(b)(1).
99. IRC §5000A(d)(2)(A).
100. IRC §5000A(d)(2)(B).
101. IRC §5000A(d)(3).
102. IRC §5000A(d)(4).
103. IRC §5000A(e)(1).
104. IRC §5000A(e)(2).
105. IRC §5000A(e)(3).
106. IRC §5000A(e)(4).
107. IRC §5000A(e)(5).

PROCEDURES FOR EXEMPT INDIVIDUALS

Clarification is provided by the proposed regulations for certain taxpayers exempt from the individual mandate to maintain MEC. In addition, guidance on the procedure used by a taxpayer to obtain an exemption was provided in proposed rules issued February 1, 2013, from HHS.[108] Some of this guidance is discussed in this section.

The Code specifically mentions that exemption certifications from a state exchange are needed for the religious sect and hardship exemptions. However, the proposed rules from the HHS suggest that in addition to administering exemption certificate procedures for religious sect and hardship exemptions, the exchanges also issue certifications for the following exemptions. [109]

- Membership in a healthcare sharing ministry
- Incarceration
- Membership in an Indian tribe

If a taxpayer believes that they qualify for a particular exemption, they must apply to the exchange for an exemption certificate. Application must be made using a form developed by HHS that provides the exchange with the necessary information to determine whether the applicant qualifies for the exemption sought.[110]

Generally, exemptions will be issued only for the calendar year in which an applicant submitted an application. However, exemptions for religious sect membership and hardship may be issued for previous tax years. [111] In addition, exemptions for membership in a religious sect and for hardship may be applied for and approved after December 31 of the year for which the application is made. For all other exemptions to be administered by the exchanges, an application for an exemption will not be accepted after the end of the tax year.[112]

All exemptions other than those for religious sect membership and hardship will also be available to the taxpayer through the tax return filing process.[113] For the exemptions that the exchanges will administer, the exchanges will have access to the information necessary to make their determinations. The exchanges will provide relevant information to the IRS regarding exemption certificates as necessary for tax administration of the shared responsibility payments.[114]

Under the HHS's proposed rules, the taxpayer has an obligation to retain the records necessary to demonstrate that an exemption certificate was received and to establish that the necessary qualifications for the exemption were met.[115]

Members of Recognized Religious Sects

For a member of a recognized religious sect to be exempt from the individual mandate, an **exemption certification** from the state exchange is required.[116] This exemption certification must indicate that the individual:

- Is a member of a recognized religious sect, and
- Adheres to established tenets or teachings of the sect.[117]

The individual is considered exempt for an entire month for which at least one day is covered by the exchange-issued exemption certification.[118]

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108. 45 CFR 155, 156; 78 FR 7348 (Feb. 1, 2013).
109. 45 CFR 155, 156; 78 FR 7348, (Feb. 1, 2013), Preamble, Part II.
110. 45 CFR 155, 156; 78 FR 7348, (Feb. 1, 2013); Proposed 45 CFR §155.610(a).
111. 45 CFR 155, 156; 78 FR 7348, (Feb. 1, 2013); Proposed 45 CFR §155.605.
112. 45 CFR 155, 156; 78 FR 7348, (Feb. 1, 2013), Preamble, Part II(c).
113. Ibid.
114. 45 CFR 155, 156; 78 FR 7348, (Feb. 1, 2013), Preamble, Part III.
115. 45 CFR 155, 156; 78 FR 7348 (Feb. 1, 2013); Proposed 45 CFR §155.610(j).
116. Prop. Treas. Reg. §1.5000A-3(a)(1).
117. Prop. Treas. Reg. §1.5000A-3(a)(2).
118. Prop. Treas. Reg. §1.5000A-3(a)(1).

Under the proposed HHS rules, an exchange generally must verify that an applicant for this exemption meets its requirements by ensuring that the applicant's religious sect is an approved religious sect under IRC §1402(g)(1). IRC §1402(g)(1) relates to the religious sect exemption for social security and Medicare tax on earnings.

Healthcare Sharing Ministries

A healthcare sharing ministry (HCSM) is defined as an organization that meets the following requirements.[119]

- Is a tax-exempt IRC §501(c)(3) organization
- Has members who share a common set of ethical or religious beliefs and share medical expenses in accordance with those beliefs without regard to their state of employment or residence
- Has members who retain their membership in the HCSM after they develop a medical condition
- Has existed continuously since December 31, 1999 (including predecessor organizations) with members who have shared medical expenses since December 31, 1999
- Has an annual audit performed by an independent CPA firm in accordance with generally accepted accounting principles and makes the audit report publicly available

An individual who is a member of an HCSM for one day or more within a calendar month is considered exempt for the full month.[120]

Individuals without Access to Affordable Coverage

Generally, an individual is **exempt** from the requirement to maintain MEC for a calendar month if the cost (referred to as the taxpayer's "required contribution") of MEC exceeds 8% (for 2014) of their **annual household income.**[121] The 8% amount for 2014 is subject to an indexing rule for subsequent tax years.[122] The guidance provided by the proposed regulations indicates that the required contribution is determined differently for taxpayers in the following three categories.

Type of Taxpayer	Required Contribution
1. An employee eligible to purchase coverage under an employer-sponsored health plan	The portion of the annual premium that the employee would pay that is attributable to the lowest cost self-only coverage available through the plan[123]
2. Family members of employees in item 1 above for whom the employee can claim a personal exemption	The part of the annual premium that is attributable to the lowest cost family coverage for all family members who are not exempt from the requirement to maintain MEC[124]
3. An individual not eligible to purchase coverage under an employer plan	The annual premium for the lowest cost bronze plan that is available from the state exchange that would cover the individual (and all family members subject to the requirement to maintain MEC, if applicable) minus the amount of PAC the individual is allowed[125]

119. Prop. Treas. Reg. §1.5000A-3(b)(2).
120. Prop. Treas. Reg. §1.5000A-3(b)(1).
121. Prop. Treas. Reg. §1.5000A-3(e)(1).
122. Prop. Treas. Reg. §1.5000A-3(e)(2)(ii).
123. Prop. Treas. Reg. §1.5000A-3(e)(3)(ii)(A).
124. Prop. Treas. Reg. §1.5000A-3(e)(3)(ii)(B).
125. Prop. Treas. Reg. §1.5000A-3(e)(4)(ii)(A).

Household income is defined as the taxpayer's MAGI plus the MAGI of all other family members for whom the taxpayer may claim a personal exemption **and** who must file a tax return for the year.[126] MAGI is generally the taxpayer's AGI increased by the following amounts.

- Any amounts excluded by the foreign earned income exclusion or foreign housing cost amounts under IRC §911
- Tax-exempt interest otherwise excluded[127]

Note. Although social security benefits are included in MAGI for purposes of determining the eligibility for, or amount of, the taxpayer's premium assistance credit (PAC), excluded social security benefits are **not** included in MAGI when calculating household income for purposes of determining whether the taxpayer is subject to the individual mandate to maintain MEC.[128]

The determination of whether coverage is affordable is based on household income for the most recent year for which income information is available.[129]

Example 27. Steve and Shawna are married and file jointly. Steve and Shawna's household income is $70,000 based on applicable 2013 MAGI amounts for their family. They have three dependents for whom they claim personal exemptions.

Steve's employer provides a health plan to its employees. Steve and his family are eligible to enroll in this health plan. In November 2013, Steve and his family can enroll in the plan for 2014. If Steve elects to purchase the lowest-cost options for himself and his family under the plan, the portion of the total cost for Steve's self-only coverage and for the family's coverage is shown in the following table. Also shown is 8% of household income for comparison purposes in order to determine whether affordable coverage exists for Steve and his family.

	Coverage Portion	Required Contribution	8% of Household Income
Coverage for Steve	Self-only coverage	$4,000	$5,600
Coverage for Shawna and three dependents	Cost for family coverage	$5,200	$5,600

Because the cost of Steve's self-only coverage is **less** than 8% of household income, Steve has affordable coverage available. In addition, Shawna and the three dependents also have affordable coverage available to them because the cost of the family coverage is less than 8% of household income. Neither Steve nor his family is exempt because of the unavailability of affordable coverage.

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126. Prop. Treas. Reg. §1.5000A-1(d)(7)(i).

127. Prop. Treas. Reg. §1.5000A-1(d)(7)(ii).

128. See Preamble, REG-148500-12, Federal Register, Vol. 78, No. 57.

129. Ibid.

Example 28. Use the same facts as **Example 27,** except Steve's household income is $60,000 for the year. A comparison of the required contribution amounts and 8% of household income follows.

	Coverage Portion	Required Contribution	8% of Household Income
Coverage for Steve	Self-only coverage	$4,000	$4,800
Coverage for Shawna and three dependents	Cost for family coverage	$5,200	$4,800

Steve has affordable coverage available to him for 2014 because his required contribution is **less** than 8% of household income. However, Shawna and the three dependents are exempt from the individual mandate to maintain MEC coverage for 2014 because their required contribution is greater than 8% of household income. Because Shawna and the three dependents are exempt from the individual mandate for 2014, there will be no shared responsibility payments triggered if the family portion of the coverage is not obtained for the 2014 plan year.

Example 29. Rebecca is a single taxpayer with no dependents. She is self-employed and not eligible to enroll in any employer-sponsored health plan. She must obtain MEC for 2014. The following amounts apply to Rebecca for the 2014 plan year.

Annual premium for lowest-cost self-only bronze plan from state exchange	$ 4,700
Annual premium for second-lowest cost self-only silver plan from state exchange ("benchmark plan")	5,000
Household income (based on amounts from Rebecca's 2013 income tax return)	35,000

In addition, for purposes of calculating Rebecca's PAC, assume that the following federal poverty guideline amounts and applicable percentage tables apply for 2014.[130]

Persons in Household	Poverty Guideline Amount
1	$11,490
2	15,510
3	19,530
4	23,550
5	27,570
6	31,590
7	35,610
8	39,630
Amount to add for each additional person over 8	4,020

130. The amounts provided in the table are the federal poverty guideline amounts for 2013. These amounts are updated each year by the HHS and published in the Federal Register. The poverty guideline amounts actually used to determine the amount of PAC for a tax year are generally those published in the prior tax year. See Treas. Reg. §1.36B-1(h).

Household Income Amount [a]	Lower Applicable Percentage	Upper Applicable Percentage
100%–133%	2.00%	2.00%
133%–150%	3.00%	4.00%
150%–200%	4.00%	6.30%
200%–250%	6.30%	8.05%
250%–300%	8.05%	9.50%
300%–400%	9.50%	9.50%

[a] Expressed as a percentage of the federal poverty guideline amount for the taxpayer's family size.

> **Note.** For further details on the PAC and the use of the appropriate federal poverty guideline amounts and percentage table, see the 2012 *University of Illinois Federal Tax Workbook,* Volume A, Chapter 7: Healthcare Reform Act.

Rebecca's 2014 household income of $35,000 is 305% of the federal poverty guideline ($35,000 ÷ $11,490). Her applicable percentage from the preceding table is therefore 9.5%.

Rebecca's PAC is the excess of her premium for the "benchmark plan" (second-lowest-cost self-only silver plan) over the amount calculated by multiplying her household income by her applicable percentage. This is expressed by the following formula.

$$\begin{aligned}\textbf{PAC} &= \textbf{Benchmark premium} - (\textbf{Household income} \times \textbf{Applicable percentage})\\ &= \mathbf{\$5{,}000} - (\mathbf{\$35{,}000} \times \mathbf{9.5\%})\\ &= \mathbf{\$5{,}000} - \mathbf{\$3{,}325}\\ &= \mathbf{\$1{,}675}\end{aligned}$$

Rebecca's 2014 required contribution is her annual premium for the lowest-cost self-only bronze plan that she can obtain through her state exchange less her PAC. Her required contribution is therefore $3,025 ($4,700 − $1,675).

Because her required contribution of $3,025 is more than 8% of her household income, or $2,800 ($35,000 × 8%), she does not have affordable coverage available to her for 2014. She is therefore exempt from the individual mandate to maintain MEC for 2014 and will not be subject to any shared responsibility payment if she does not obtain coverage.

> **Note.** The preceding three examples assume that the taxpayer's eligibility to obtain coverage through an employer-sponsored plan does not change during the tax year. If there is a change in this regard, the calculations must be made on a month-to-month basis for each period. In addition, each employment period that is less than a calendar year or parts of an employer's plan year that are in different tax years must have separate affordability determinations made.[131] For further guidance on how the calculations for affordability are performed for these part-year situations, see Prop. Treas. Reg. §1.5000A-3.

131. Prop. Treas. Reg. §1.5000A-3(e)(3)(ii)(C).

Taxpayers with Household Income below Filing Threshold

An individual is exempt from the individual mandate for any tax year in which the individual's household income for the most recent tax year for which information is available is below the individual's filing threshold.[132] The filing threshold for most individuals is the applicable exemption amount plus the standard deduction amount. For joint filers, the filing threshold is twice the exemption amount plus the standard deduction amount.[133] For MFS filers, the threshold is the exemption amount only.[134]

The filing thresholds for the **2013 tax year** are as follows.

Filing Status	Filing Threshold Amount
S	$10,000
MFJ	20,000
MFS	3,900
HoH	12,850
QW	16,100

Example 30. Franz and Gretchen are married and file jointly for 2014. Their 2013 household income is $17,750. This is below the 2013 MFJ filing threshold of $20,000. Franz and Gretchen are not required to file a 2013 tax return and in January 2014, when the individual mandate becomes effective, they will not be subject to its requirement to maintain coverage for 2014.

Example 31. Assume the same facts as **Example 30,** except Franz and Gretchen have 2013 household income of $26,000. Not only must they file a 2013 return but they must ensure that each of them have MEC in place (or qualify for some other exemption from the individual mandate) for 2014. Otherwise, they may face assessment of shared responsibility payments in connection with the months during 2014 for which they do not have MEC.

Hardship Exemption

An exemption certificate may be issued to an individual in connection with hardship circumstances.[135] HHS has outlined in its proposed rules various circumstances that may result in such an exemption. These are as follows.[136]

- The taxpayer experiences a significant, unexpected increase in essential expenses due to financial or domestic circumstances, including a natural or human-caused event.
- The taxpayer is unable to bear the expense of purchasing coverage without causing serious deprivation of food, shelter, clothing, or other necessities.
- No affordable coverage is available to the taxpayer.
- The taxpayer was not required to file a tax return because gross income was below the filing threshold but filed a return to obtain a tax benefit, claimed a dependent with a filing requirement, and had resulting household income above the return filing threshold for purposes of the individual mandate rules.

132. Prop. Treas. Reg. §1.5000A-3(f); Preamble, REG-148500-12, Federal Register, Vol. 78, No. 57.

133. IRC §6012(a)(1)(A)(iv).

134. IRC §6012(a)(1)(A).

135. Prop. Treas. Reg. §1.5000A-3(h)(2)F.

136. 45 CFR 155, 156; 78 FR 7348 (Feb. 1, 2013); Proposed 45 CFR §155.605(g).

- The individuals would be eligible for Medicaid but lives in a state that elected not to expand Medicaid eligibility.
- The taxpayer and one or more other employed family members were determined eligible for employer-sponsored coverage for the year through their respective employer plans but the aggregate cost for the coverage for all such employed family members is greater than 8% of household income for some or all of the year.

> **Note.** This provision is similar to the exemption for unavailable affordable coverage. HHS has indicated that the exchanges will verify and issue exemptions for unavailable affordable coverage based on **projected** household income.

- The taxpayer has been prevented from obtaining MEC by other circumstances.

> **Note.** For further details and guidance on all of the various exemptions that apply, including the exemption for members of an Indian tribe or for short gaps in coverage, see Prop. Treas. Reg. §1.5000A-3 and the 2012 *University of Illinois Federal Tax Workbook,* Volume A, Chapter 7: Healthcare Reform Act.

LIABILITY FOR SHARED RESPONSIBILITY PAYMENTS

A nonexempt taxpayer is liable for a shared responsibility payment for any month for which the taxpayer did not have MEC in connection with the taxpayer's own health care. Joint filers are jointly liable for the shared responsibility payment.[137]

Rules for Dependents

A taxpayer is liable for shared responsibility payments for any dependents who do not have MEC in place for that dependent's own healthcare.[138] An individual meeting the IRC §152 definition is considered a dependent of the taxpayer under individual mandate rules **even if the taxpayer does not actually claim a dependency exemption for that person.**[139]

> **Note.** The definition of "dependent" used under the individual mandate rules is the same as that used for purposes of the dependency exemption under IRC §152.[140]

If the dependency exemption may be claimed by more than one individual, the taxpayer who **properly claims** the exemption is liable for any shared responsibility payment arising from a lack of MEC for that dependent. No further guidance exists on the meaning of "properly claims" for this rule.

> **Observation.** Although the proposed regulations offer specific guidance and special rules for children who are adopted or given up for adoption (and for foster care situations),[141] no specific guidance exists with respect to liability for shared responsibility payments in **divorce** situations. This may cause unexpected tax consequences for divorced taxpayers.

137. Prop. Treas. Reg. §1.5000A-1(c)(3).
138. IRC §5000A(b)(3)(A).
139. Ibid.
140. Prop. Treas. Reg. §1.5000A-1(c)(2).
141. See Prop. Treas. Reg. §1.5000A-1(c)(2)(ii).

Example 32. Fred and Pam are divorced. Pam is the custodial parent of their 14-year-old daughter, Kyra. Because Pam is the custodial parent, she is entitled to claim the dependency exemption for Kyra. However, for 2014, Pam agrees to transfer her right to the dependency exemption to Fred. Accordingly, she completes and signs the required IRS Form 8332, *Release/Revocation of Release of Claim to Exemption for Child by Custodial Parent.* **It appears that Fred is liable for any 2014 shared responsibility payment arising from a lack of MEC for Kyra because he is the taxpayer who may properly claim the dependency exemption for her.**

Example 33. Assume the same facts as **Example 32,** except Pam obtains MEC for herself and for Kyra at the beginning of 2014. After the first six months of 2014, Pam cancels the MEC for Kyra. At the end of 2014, she completes and signs Form 8332 and transfers her right to Kyra's dependency exemption to Fred. Because it appears that Fred is entitled to properly claim Kyra's dependency exemption, he is liable for any shared responsibility payment that arises as a result of the lack of any MEC for Kyra **for the last six months** of 2014.

The priority rules of IRC §152 are used to determine which taxpayer is liable for any shared responsibility payment attributable to a dependent if more than one taxpayer may claim the dependency exemption for that dependent but no such claim is made.[142]

IRS Enforcement

Liability for an individual shared responsibility payment is reported on the taxpayer's tax return for the year that includes the months for which the shared responsibility payments were triggered. A shared responsibility payment will be assessed like a penalty. However, the IRS has limited options in attempting to collect the unpaid shared responsibility payments, as shown below.

- The IRS cannot issue a notice of federal tax lien.[143]
- The IRS cannot levy property.[144]
- No criminal prosecution can be initiated.[145]

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142. Prop. Treas. Reg. §1.5000A-1(c)(2)(i).

143. IRC §5000A(g)(2)(B)(i).

144. IRC §5000A(g)(2)(B)(ii).

145. IRC §5000A(g)(2)(A).

EMPLOYER MANDATE

Note. In July 2013, the Obama administration announced that the new employer and insurer reporting requirements under the ACA that were scheduled to become effective in 2014 have been delayed for one year. Throughout this section, the effective date mentioned is 2014, but the **enforcement** of the employer mandate provisions are delayed to January 1, 2015.

The following acronyms are used in this section.

- ACA — Affordable Care Act
- ALE — Applicable large employer
- DOL — Department of Labor
- FTE — Full-time equivalents
- HBE — Health benefit exchange
- MAGI — Modified adjusted gross income
- MEC — Minimum essential coverage
- PAC — Premium assistance credit

The following quote is from the Treasury Department, made on July 2, 2013.

The Administration is announcing that it will provide an additional year before the ACA mandatory employer and insurer reporting requirements begin. This is designed to meet two goals. First, it will allow us to consider ways to simplify the new reporting requirements consistent with the law. Second, it will provide time to adapt health coverage and reporting systems while employers are moving toward making health coverage affordable and accessible for their employees. . .

Here is some additional detail. The ACA includes information reporting (under section 6055) by insurers, self-insuring employers, and other parties that provide health coverage. It also requires information reporting (under section 6056) by certain employers with respect to the health coverage offered to their full-time employees. We expect to publish proposed rules implementing these provisions this summer, after a dialogue with stakeholders — including those responsible employers that already provide their full-time work force with coverage far exceeding the minimum employer shared responsibility requirements — in an effort to minimize the reporting, consistent with effective implementation of the law. . .

We recognize that this transition relief will make it impractical to determine which employers owe shared responsibility payments (under section 4980H) for 2014. Accordingly, we are extending this transition relief to the employer shared responsibility payments. These payments will not apply for 2014. Any employer shared responsibility payments will not apply until 2015.[146]

146. *Continuing to Implement the ACA in a Careful, Thoughtful Manner,* [www.treasury.gov/connect/blog/pages/continuing-to-implement-the-aca-in-a-careful-thoughtful-manner-.aspx] Accessed on August 8, 2013.

The ACA created IRC §4980H. This Code section subjects certain employers to **shared responsibility** rules as part of healthcare reform. Because many employers will become subject to these new rules and will be required to provide a minimum of affordable health coverage or pay a penalty beginning on January 1, 2014 (enforcement delayed until 2015), it is essential that tax practitioners understand these complex rules. This section covers the following key features of the employer mandate.

- How to determine whether an employer is subject to the mandate
- The obligations imposed on an affected employer
- How employer penalties are triggered

On December 31, 2012, the IRS and the Treasury Department issued proposed regulations regarding the employer obligations under IRC §4980H.[147]

DETERMINING WHETHER THE EMPLOYER IS AN APPLICABLE LARGE EMPLOYER

Effective at the beginning of the 2014 tax year, **applicable large employers** (ALEs) must meet various requirements regarding health coverage for employees. Although the rules do not obligate an ALE to provide health coverage to full-time employees, the ALE may be penalized if they do not offer minimum health coverage to them.

Employers are subject to the shared responsibility rules only if they meet the definition of an ALE. An ALE is generally an employer that employed an average of **at least 50 full-time employees** on business days during the previous calendar year.

Two issues must be addressed in order to determine whether an employer is an ALE.

1. The employer must determine which workers are **employees.**
2. The employer must determine its number of **full-time employees** for the prior calendar year.[148]

In order to determine whether an employer meets the definition of an ALE for the current year, the previous year's total work hours of full-time and part-time employees are considered. The following sections provide details on how the ALE determination is made.

Which Workers Are Employees

In order for a worker to qualify as an employee, the worker must have an **employment relationship** with the employer. The proposed regulations adopt the common law "right-of-control" test of "employee" for purposes of the ALE shared responsibility rules.[149] The right-of-control test, which largely focuses on the degree of employer control, is determined by analyzing the 20 factors that the IRS considers in deciding whether a worker is an employee or an independent contractor. These factors are found in Rev. Rul. 87-41.[150]

> **Note.** For a complete listing and analysis of the 20 factors, see the 2012 *University of Illinois Federal Tax Workbook,* Volume C, Chapter 5: Employment Issues.

147. REG-138006-12, Federal Register Vol. 78, No. 1.

148. Prop. Treas. Reg. §54.4980H-2(b)(1).

149. Prop. Treas. Reg. §54.4980H-1(a)(13).

150. Rev. Rul. 87-41, 1987-1 CB 296.

The following types of workers are not considered employees and are not included when counting full-time employees for purposes of the definition of an ALE.[151]

- Independent contractors
- Leased employees[152]
- Partners in a partnership
- S corporation shareholders who own more than a 2% interest
- Sole proprietors

Determining the Number of Full-Time Employees

When calculating the 50-full-time-employee test for ALE purposes, the following qualify as full-time employees.

1. Full-time employees of the employer, and
2. **"Full-time equivalent"** (FTE) employees.

An employee is considered full-time when they **work an average of at least 30 hours per week.** For purposes of this rule, 130 service hours in one calendar month is considered the monthly equivalent of 30 weekly service hours. The employer may use this monthly equivalency rule only if it is used reasonably and consistently.[153]

For employees who are **paid hourly,** an employer must use the employee's actual service hours from payroll or other records.[154]

For employees who are **not paid hourly,** the employer must use one of the following methods to determine whether the employee meets the 30-hours-per-week requirement and therefore qualifies as a full-time employee.[155]

1. Actual hours of service from payroll or other records, if available
2. Days-worked equivalency, whereby the employee is credited for eight hours of service for each day that the employee would obtain at least one hour of credited service if that employee were hourly
3. Weeks-worked equivalency, whereby the employee is credited for 40 hours of service for each week that they would obtain at least one hour of credited service if that employee were hourly

Although the employer must use one of the preceding three methods to determine the number of hours worked for **non-hourly employees,** the employer is not required to use the same method for all non-hourly employees. Different methods may be used for different classifications of employees as long as those classifications are consistently applied and are reasonable.[156]

Note. The employer is not permitted to use the days-worked or weeks-worked equivalency methods if the result would disqualify the employee as a full-time employee by substantially understating that employee's hours of service.[157]

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151. Prop. Treas. Reg. §54.4980H-1(a)(13).
152. See IRC §414(n)(2) for a definition of "leased employee."
153. Prop. Treas. Reg. §54.4980H-1(a)(18).
154. Prop. Treas. Reg. §54.4980H-3(b)(1).
155. Prop. Treas. Reg. §54.4980H-3(b)(2)(i).
156. Prop. Treas. Reg. §54.4980H-3(b)(2)(ii).
157. Prop. Treas. Reg. §54.4980H-3(b)(2)(iii).

Full-Time Equivalents (FTEs). All employees who are not full-time employees are considered in determining whether they collectively work enough hours to constitute one or more FTEs. **All employees who did not work at least 30 service hours per week for a calendar month in the preceding calendar year are included in calculating the number of FTEs for that month.**[158]

To calculate the number of FTEs, the number of hours worked during the calendar month by **all** employees in the group are totaled. This total is then divided by 120. For FTE purposes, fractions are taken into account.[159]

Example 34. Thermofridge Enterprises, Inc. (Thermofridge) has 17 employees, each of whom works an average of 33 hours per week in each month of 2014. In addition, there are 48 part-time employees. Each of the part-time employees averages 80 hours of service each month for 2014. Thermofridge must determine whether it is an ALE for 2015 based on the number of their employees and the average hours the employees have worked during 2014. Thermofridge makes this determination using the following calculations.

First, the 17 employees who average 33 hours per week in each month of the previous year are counted as full-time employees because these employees have worked at least 30 hours per week each calendar month for the preceding year.[160]

In addition to the 17 full-time employees, Thermofridge must calculate the number of FTEs to determine whether it has 50 or more full-time employees.

$$\begin{aligned}\textbf{Number of FTEs} &= \frac{\textbf{Aggregate number of hours worked by all part-time employees}}{\textbf{120}} \\ &= \frac{\textbf{48 part-time employees} \times \textbf{80 average hours}}{\textbf{120}} \\ &= \frac{\textbf{3840}}{\textbf{120}} \\ &= \textbf{32 FTEs in each month during 2014}\end{aligned}$$

For purposes of the employer shared responsibility rules, Thermofridge has a total of 49 employees in 2014 (17 full-time employees + 32 FTEs). Therefore, it is not subject to the employer mandate in 2015 because it does not have at least 50 full-time employees in 2014.[161]

Note. If the result of the FTE calculation is **not a whole number,** it is rounded to the **next lowest whole number** in determining the number of FTEs.[162]

Transition Rule for 2013/2014

As previously explained, employee data for the prior year is taken into consideration when determining whether an employer is an ALE for the following year. An employer may become subject to the shared responsibility rules for the first time for 2014 based on 2013 employee data. Recognizing that employers may need time to interpret and adapt to the new rules, the Treasury Department and the IRS have provided a special transition rule for determining ALE status for 2014. Under this transition relief, an employer determining 2014 ALE status may refer to employee data in any six consecutive calendar months in 2013 instead of the entire 2013 calendar year.[163]

158. Prop. Treas. Reg. §54.4980H-2(c)(1).
159. Prop. Treas. Reg. §54.4980H-2(c)(2).
160. Prop. Treas. Reg. §§54.4980H-1(a)(18) and 54.4980H-2(b).
161. Prop. Treas. Reg. §54.4980H-2(c)(2).
162. Prop. Treas. Reg. §54.4980H-2(b)(1).
163. See Preamble, REG 138006-12, Part IX.E, Federal Register, Vol. 78, No. 1.

Seasonal Worker Rule

If the sum of the employer's full-time employees and FTEs exceeds 50 for any period of no more than 120 days in the prior year because of **work performed by seasonal workers,** the employer will not be considered an ALE in the following year.

Under Prop. Treas. Reg. §54.4980H-1(a)(34), a seasonal worker is defined as a worker who performs work on a seasonal basis. The proposed regulation states that this includes those included in the definition of seasonal or temporary laborers under Department of Labor (DOL) rules.[164] The DOL rules refer to employment exclusively performed at certain seasons or periods of the year which, by its nature, may not be continuous or carried on throughout the year. **The proposed regulation specifically mentions that retail workers employed exclusively during holiday seasons are considered seasonal workers.**

For the purposes of the ALE determination, any four calendar months in the prior year may be treated as the equivalent of the 120-day period at the option of the employer. The 120-day (or 4-month) period does not need to be consecutive.

New Employers

A new employer may not have access to employee data for the full prior year in order to make an ALE determination for the current year. A new employer that has not existed throughout the previous calendar year will be considered an ALE if in the current year:

- That employer **reasonably expects** to employ an average of at least 50 full-time employees (including FTEs), **and**
- That employer **actually** employs an average of at least 50 full-time employees (including FTEs) on business days during the current calendar year.

Employers under Common Control

One or more employers that are under common control are collectively considered one employer for purposes of determining whether that employer is an ALE. The number of full-time employees (including FTEs) for **all** the commonly controlled entities must be aggregated to make a final determination as to whether the control group constitutes an ALE that is subject to the employer mandate. Each of the individual employers under common control is referred to as an **ALE member,** which is part of the overall ALE. Each ALE member is treated as an ALE.[165]

To determine whether common control exists, the aggregation rules of IRC §§414(b), (c), (m), and (o) are used.[166] For example, parent-subsidiary and brother-sister relationships comprise one employer for purposes of determining whether an ALE exists.[167]

> **Note.** For additional guidance on the various types of common-control relationships between employers that must be aggregated into one larger employer for purposes of determining whether an ALE exists, see IRC §§414(b), (c), (m) and (o) and the underlying regulations. Proposed regulations have reserved commenting on the application of the aggregation rules to government entities, churches, church associations, or conventions. Further guidance is expected regarding how the aggregation rules apply to these specific groups.[168]

164. See 29 CFR 500.20(s)(1).
165. Prop. Treas. Reg. §§54.4980H-2(a), (d).
166. Prop. Treas. Reg. §54.4980H-2(d).
167. Treas. Reg. §1.414(c)-2.
168. See Preamble, REG 138006-12, Federal Register, Vol. 78, No. 1.

EMPLOYER REPORTING

In addition to being subject to the employer mandate rules, an ALE must comply with two reporting requirements.

- An annual return must be filed with the **IRS.**[169]
- An annual information report must be given to **full-time employees.**

Annual Employer Reporting to the IRS

Beginning with the 2014 tax year, ALEs have annual reporting requirements. A return must be filed with the IRS that includes the following information.[170]

- The name and employer identification number of the ALE filing the return
- The date the return is filed
- Certification of whether the ALE offers **full-time employees (and their spouse and dependents)** the opportunity to enroll in MEC under an eligible employer-sponsored health plan and, if so:
  - The duration of the waiting period for the coverage offered,
  - The months of the calendar year that the coverage offered was available to full-time employees,
  - The amount of monthly premium for the lowest-cost option in each of the enrollment categories under the plan, and
  - The employer's share of the total allowed costs of benefits under the plan
- The number of full-time employees for each month of the calendar year and details for each full-time employee, including the employee's name, address, social security number, and the months that the employee had plan coverage
- Any other information required by the IRS

> **Note.** IRC §6056(b) and IRS Notice 2012-33 outline this annual ALE filing requirement. The IRS Notice requested public comments on this annual filing requirement in anticipation of the publication of proposed regulations at a later date. Notice 2012-33 did not provide any annual date or deadline by which this annual report to the IRS must be filed. Presumably, the IRS will develop a form to be used to report the required information.

Annual Employer Reporting to Employees

The ALE must also furnish a written statement to each full-time employee identified in the annual IRS return.[171] This statement must be furnished to these full-time employees no later than January 31 of the year following the calendar year for which the IRS return was filed. The statement must include the following information.

- The name, address, telephone number, and contact information of the ALE
- The same coverage-related information for the employee that was indicated on the return filed with the IRS[172]

> **Note.** Further guidance on this ALE requirement is anticipated.

169. IRC §6056(b).
170. IRC §6056(b); IRS Notice 2012-33, 2012-20 IRB 912.
171. IRC §6056(c).
172. IRS Notice 2012-33, 2012-20 IRB 912.

EMPLOYER MANDATE PENALTIES

Beginning with the 2014 tax year, an ALE may be subject to a penalty (referred to as a "shared responsibility payment"). There are two possible penalties and an ALE may be subject to one of them if the circumstances "trigger" the penalty. Generally, the two penalties are as follows.

1. A penalty under IRC §4980H(a) for an ALE that **does not** offer MEC to its full-time employees and their dependents
2. A penalty under IRC §4980H(b) for an ALE that **does** offer MEC to its full-time employees

The basic features of each of the above two penalties and the circumstances that trigger them are discussed in the following sections.

The §4980H(a) Penalty

The ACA does not require employers to provide health insurance coverage to employees. However, an ALE **not offering health insurance coverage** faces a penalty if:

1. It fails to offer its full-time employees (and their spouse and dependents) the opportunity to enroll in MEC under an eligible employer-sponsored health plan for any month, **and**
2. It has at least one full-time employee who has been:
    a. Certified to the employer as having enrolled for that month in a qualified health plan obtained through the state's health benefit exchange (HBE), **and**
    b. The HBE coverage obtained by the employee is coverage for which the employee can receive either the premium assistance credit (PAC) or other cost-sharing arrangement.[173]

Under procedures to be developed by HHS, if a full-time employee obtains coverage from a state exchange for any month or months within the calendar year and receives a PAC or cost-sharing subsidy, the ALE will receive a Section 1411 certification.[174] A Section 1411 certification is received for each employee obtaining such health coverage who also receives a PAC or subsidy. The ALE will owe a penalty in the calendar months indicated for their employees who receive certifications.

> **Note.** For details and guidance on the PAC, cost-sharing subsidies, and calculation of the §4980H(a) penalty, see the 2012 *University of Illinois Federal Tax Workbook,* Volume A, Chapter 7: Healthcare Reform Act.

The ALE must offer coverage to every full-time employee **each day of the calendar month** to avoid the §4980H(a) penalty. If the ALE fails to offer coverage for **any day during the month** to one or more employees, the ALE is treated as failing to offer coverage to those employees for that **entire** calendar month.[175] If an employee terminates employment during the month, the employer is treated as offering coverage for the full month in which employment terminated if coverage would have been offered to the employee had they remained employed for the full calendar month.[176]

The §4980H(a) penalty for an employer **not offering health coverage** is triggered when an employee obtains coverage through the state exchange and receives the PAC or a cost-sharing subsidy used toward the purchase of the health coverage. Therefore, it is possible for an employer not offering coverage to avoid a penalty.

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173. IRC §4980H(a).
174. Prop. Treas. Reg. §54.4980H-1(a)(35).
175. Prop. Treas. Reg. §54.4980H-4(c).
176. Ibid.

Example 35. ABD Technologies, Inc., is an ALE. Its full-time employees with household incomes up to 400% of the federal poverty guideline may qualify for a PAC and cost-sharing subsidy. Each of ABD's full-time employees has household income that is **in excess** of 400% of the federal poverty guideline. Because no full-time employee (or member of the employee's family) qualifies for the PAC or a subsidy for health coverage purchased on the state exchange, ABD Technologies, Inc. is not liable for the §4980H(a) penalty.

An employer that offers MEC under an eligible employer-sponsored plan to its full-time employees and their dependents is not subject to any §4980H(a) penalty. However, that employer may be subject to a §4980H(b) penalty (discussed next) if the coverage does not meet certain minimum standards (such as providing minimum value or qualifying as affordable coverage for the full-time employees enrolled).[177]

Safe Harbor Rule. The Treasury Department and the IRS have indicated that an ALE is not subject to the penalty under §4980H(a) if the employer **intends** to offer MEC to all full-time employees but fails to offer such coverage to a few employees. The proposed regulations indicate that an ALE is treated as offering coverage to **all** full-time employees if it offers coverage to **all but 5%** of its full-time employees (or five individuals, if greater). The purpose of this rule is to shield an employer from the §4980H(a) penalties when it offers coverage to at least 95% of full-time employees but a few employees are not offered coverage due to administrative or other errors. This safe harbor applies regardless of whether the failure to offer coverage to some employees was inadvertent.[178]

The §4980H(b) Penalty

An ALE **offering MEC** faces a penalty if that employer:

1. Offers full-time employees (and their spouse and dependents) the opportunity to enroll in MEC under an eligible employer-sponsored plan for any month, **and**
2. Despite offering that coverage, has one or more full-time employees who have been:
   a. Enrolled in a qualified health plan obtained through a state HBE, **and**
   a. The HBE coverage obtained by the employee is coverage for which the employee can receive either the PAC or other cost-sharing arrangement (subsidy).[179]

> **Observation.** An employer cannot be liable for a penalty under **both** §§4980H(a) and 4980H(b) for the same month.

The coverage offered by an ALE to its full-time employees must meet certain minimum standards. The coverage must:

- Be **minimum essential coverage**,
- Be **affordable** coverage as defined in IRC §36B(c)(2)(C)(i), and
- Provide **minimum value** as defined in IRC §36B(c)(2)(C)(ii).

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177. See Preamble, REG 138006-12, Part IV, Federal Register, Vol.78, No. 1.

178. Prop. Treas. Reg. §54.4980H-4(a); Preamble, REG 138006-12, Part IV. D, Federal Register, Vol. 78, No. 1.

179. IRC §4980H(b).

Minimum Essential Coverage. MEC is coverage that is provided through one of the following.

- A federal government-sponsored program (including Medicare, Medicaid, the Children's Health Insurance Program, medical coverage such as TRICARE provided to the armed forces, the veteran's healthcare program, and the Peace Corps health plan)
- An eligible employer-sponsored plan (including group health coverage and group plans obtained through a state exchange and government employee plans)
- Individual market plans provided for individuals outside of a group health plan
- Grandfathered plans (defined later)
- Other coverage, plans, or programs that the Secretary of HHS and the Treasury Secretary indicate qualify as MEC

> **Note.** Further guidance is expected on the definitions of MEC and "eligible employer-sponsored plan."[180] IRC §5000A(f)(2) generally defines an eligible employer-sponsored plan as certain governmental plans or any other plan offered in the small- or large-group market in a state.

Coverage that **does not** qualify as MEC includes the following.

- Coverage that provides only accident and/or disability insurance
- Liability insurance (including general and automobile liability coverage) and coverage issued as a liability insurance supplement
- Workers' compensation or similar coverage
- Automobile medical payment coverage
- Coverage for an onsite medical facility
- Credit-only insurance, such as mortgage insurance
- Other coverage specified in a regulation that provides medical care benefits that are secondary or incidental to other insurance benefits

In addition, if the following types of coverage are provided through a separate policy or contract, they do not qualify as MEC.

- Limited scope vision or dental coverage
- Long-term care, home care, or nursing home care coverage
- Specific-illness coverage
- Hospital indemnity or other fixed indemnity coverage
- Coverage that is supplementary to a group health plan, Medicare supplemental coverage, and certain supplemental military health and dental coverage

These various types of coverage are specified in either IRC §5000A(f) or §2791 of the Public Health Service Act.[181]

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180. Preamble, REG 138006-12, Part III.A, Federal Register, Vol. 78, No. 1.

181. PL 78-410.

Affordable Coverage. In order for the coverage to be affordable, the employee's required contribution for self-only coverage **must not exceed 9.5%** of the employee's household income.[182] Household income is defined as the **sum** of the MAGI amounts for the full-time employee and for the employee's family (including spouse and dependents) who are required to file a federal tax return.

> **Note.** For further information on the definitions of MAGI and household income, see the 2012 *University of Illinois Federal Tax Workbook,* Volume A, Chapter 7: Healthcare Reform Act.

Employers that provide the opportunity for full-time employees and their dependents to enroll in MEC may take advantage of one or more affordability safe harbors provided by the proposed regulations. Reliance by an employer on an affordability safe harbor ensures that the employer will not be subject to a §4980H(b) penalty for the period of time during which the health coverage is deemed affordable by the safe harbor rule. This deemed affordability safe harbor will prevail even if the coverage is, in fact, not affordable for one or more employees who qualify for a PAC or cost-sharing subsidy.[183]

Form W-2 Safe Harbor. If an **employee's cost** for the lowest-cost, self-only coverage under the employer's plan is **not more than 9.5%** of the wages from that employer as shown on the employee's Form W-2, the employer will **not** be liable for the §4980H(b) penalty for that employee. This safe harbor is applied on an employee-by-employee basis after the end of the tax year by comparing the amount of the employee's cost for the lowest-cost, self-only coverage to their Form W-2 wages for the year.[184]

Rate of Pay Safe Harbor. For an hourly employee, the employer must multiply the employee's hourly rate by 130 to arrive at a monthly rate of pay. If an **employee's cost** for the lowest-cost, self-only coverage under the employer's plan is not more than 9.5% of the calculated wage amount, the employer will not be subject to the §4980H(b) penalty for that employee.

For a salaried employee, the safe harbor determination is made in a similar fashion using the salaried employee's monthly rate of pay.

Federal Poverty Guideline Safe Harbor. If an **employee's cost** for the lowest-cost, self-only coverage under the employer's plan is **not more than 9.5%** of the federal poverty guideline **monthly** amount, the employer will not be subject to a §4980H(b) penalty in connection with that employee. The federal poverty guideline monthly amount is calculated by taking the annual federal poverty guideline amount for the state in which the employee is employed and dividing by 12.

> **Note.** For further guidance and details in connection with the three affordability safe harbors on which an employer may rely, see Prop. Treas. Reg. §54.4980H-5(e)(2).

182. IRC §36B(c)(2)(C)(i).

183. Prop. Treas. Reg. §54.4980H-5(e)(2).

184. Prop. Treas. Reg. §54.4980H-5(e)(2)(ii).

Minimum Value. Generally, a plan provides minimum value if the plan covers at least 60% of the cost of total allowed benefits under the plan. IRS Notice 2012-31[185] describes various methods to determine whether a plan provides minimum value.

> **Observation.** A full-time employee or member of the full-time employee's family who can enroll in an employer-sponsored plan is **not eligible** for any PAC to purchase coverage on the state exchange unless the employer's plan is either unaffordable or does not provide minimum value. Therefore, if the employer offers coverage that meets the definition of affordable and that provides minimum value, the employer is not liable for the §4980H(b) penalty. In addition, the employer is not liable for a §4980H(b) penalty if the employee obtains a PAC or cost-sharing subsidy for a dependent.[186]

Offer of Coverage. In order to meet the "offer of coverage" requirement under §4980H(b), the ALE must provide its full-time employees with the effective opportunity to enroll in the plan at least once per year. Whether the employee has an effective opportunity to do so is determined by looking at all the facts and circumstances. Among the factors considered are the following.

- The adequacy of any notice provided to the full-time employees
- The amount of time the full-time employees had to enroll in the plan
- Other conditions of the offer

With respect to employer substantiation and recordkeeping to show that the "offer of coverage" requirement has been met, the proposed regulations make reference to the generally applicable requirements found in IRC §6001 and Rev. Proc. 98-25.[187] The proposed regulations provide no further guidance on what documentation or recordkeeping will suffice to show that the "offer of coverage" requirement has been met.

Grandfathered Health Plans. Grandfathered health plan coverage is coverage under a group health plan or coverage provided by an issuer of health insurance in which a person was enrolled on March 23, 2010.[188] This special grandfathered plan provision allows many existing health plans to remain in place after the January 1, 2014, effective date of the employer mandate. The plan must maintain its grandfathered status by continually meeting certain requirements, including the following.[189]

- Continually providing health coverage to at least one person at all times
- Disclosing its status as a grandfathered plan to participants and describing the benefits provided
- Providing contact information to address participant complaints or questions about the plan
- Maintaining documentation regarding the terms of the plan and its grandfathered status and making this documentation available for examination upon request

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185. IRS Notice 2012-31, 2012-20 IRB 906.

186. Preamble, REG 138006-12, Part I, Federal Register, Vol. 78, No. 1.

187. Preamble, REG 138006-12, Part IV.C.1, Federal Register, Vol. 78, No. 1.

188. March 23, 2010, is the date the Affordable Care Act became effective.

189. Temp. Treas. Reg. §54.9815-1251T.

If the plan's administrators fail to meet the above requirements, the plan loses its grandfathered status. In addition, unless transitional rules apply, making certain changes to a grandfathered plan from the terms that existed on March 23, 2010, will cause the plan to lose its grandfathered status. Such changes include the following.

- Eliminating all or substantially all of the benefits to treat a particular condition
- Increasing a participant's percentage cost-sharing requirement (such as an increase in the coinsurance amount)
- Increasing a participant's fixed-amount cost-sharing requirement other than a copayment (such as an increase in deductibles or out-of-pocket limits)
- Subjecting a plan to an annual or lifetime limit on benefits paid that had no such limit on March 23, 2010[190]

Under transitional rules, if any of these changes became effective after March 23, 2010, as a result of a contractual change, state insurance department filing, or a written and adopted plan amendment that existed before March 23, 2010, the changes will not terminate the grandfathered status.[191]

> **Note.** For details and guidance on how the §4980H(b) penalty is calculated, see the 2012 *University of Illinois Federal Tax Workbook,* Volume A, Chapter 7: Healthcare Reform Act.

190. Temp. Treas. Reg. §54.9815-1251T(g)(1).

191. Temp. Treas. Reg. §54.9815-1251T(g)(2).