

HIGHLIGHTS OF THIS ISSUE

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

INCOME TAX

Rev. Rul. 2012-16, page 1035.

Interest rates; underpayments and overpayments. The rates for interest determined under section 6621 of the Code for the calendar quarter beginning July 1, 2012, will be 3 percent for overpayments (2 percent in the case of a corporation), 3 percent for the underpayments, and 5 percent for large corporate underpayments. The rate of interest paid on the portion of a corporate overpayment exceeding \$10,000 will be 0.5 percent.

Notice 2012-40, page 1046.

This notice provides guidance on the limits in section 125(i) of the Code on salary reduction contributions to health flexible spending arrangements, effective for cafeteria plan years beginning after December 31, 2012, and also requests comments on possible modification to the “use-or-lose” rule in the proposed section 125 regulations.

Notice 2012-42, page 1049.

Credit for carbon dioxide sequestration; 2012 section 45Q inflation adjustment factor. This notice publishes the inflation adjustment factor for the carbon dioxide (CO₂) sequestration credit under section 45Q of the Code for calendar year 2012.

EMPLOYEE PLANS

Notice 2012-43, page 1050.

Weighted average interest rate update; corporate bond indices; 30-year Treasury securities; segment rates.

This notice contains updates for the corporate bond weighted

average interest rate for plan years beginning in June 2012; the 24-month average segment rates; the funding transitional segment rates applicable for June 2012; and the minimum present value transitional rates for May 2012.

EMPLOYMENT TAX

Rev. Rul. 2012-18, page 1032.

Tips included for both employee and employer taxes.

This ruling provides guidance for employers and employees in a question and answer format regarding taxes imposed on tips under the Federal Insurance Contributions Act (FICA), including information on the difference between tips and service charges, the reporting of the employer share of FICA under section 3121(q) of the Code, and the section 45B credit. See related Announcement 2012-25, published elsewhere in this Bulletin. Rev. Rul. 95-7 modified and superseded.

Announcement 2012-25, page 1054.

This announcement is seeking comments from the public regarding an interim guidance memo (IGM) issued to its examiners relating to Rev. Rul. 2012-18, published elsewhere in this Bulletin. The IGM provides audit issue direction to examiners in dealing with issues concerning the proper treatment of tips and service charges. This announcement also announces plans to solicit comments in the future regarding possible changes to voluntary tip compliance agreements.

(Continued on the next page)



ADMINISTRATIVE

Rev. Rul. 2012–18, page 1032.

Tips included for both employee and employer taxes.

This ruling provides guidance for employers and employees in a question and answer format regarding taxes imposed on tips under the Federal Insurance Contributions Act (FICA), including information on the difference between tips and service charges, the reporting of the employer share of FICA under section 3121(q) of the Code, and the section 45B credit. See related Announcement 2012–25, published elsewhere in this Bulletin. Rev. Rul. 95–7 modified and superseded.

Notice 2012–41, page 1048.

This notice provides an extension of time to pay under section 6651 of the Code to eligible civilian spouses of military servicemembers who work in American Samoa, Guam, the Northern Mariana Islands, Puerto Rico, or the U.S. Virgin Islands (each a “U.S. territory”) and claim residence or domicile for tax purposes in a State or the District of Columbia pursuant to the Military Spouses Residency Relief Act (“MSRRA”), for tax year 2011 and subsequent tax years. In addition, this notice provides that civilian spouses of military servicemembers working in a State or the District of Columbia but claiming residence or domicile for tax purposes in a U.S. territory under MSRRA should follow the procedures described in Notice 2010–30 with respect to their individual income tax returns for tax year 2011 and subsequent tax years.

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force the law with integrity and fairness to all.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents are compiled semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

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

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

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations,

court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1986 Code.

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

Part II.—Treaties and Tax Legislation.

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

Part III.—Administrative, Procedural, and Miscellaneous.

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

Part IV.—Items of General Interest.

This part includes notices of proposed rulemakings, disbarment and suspension lists, and announcements.

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

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

Section 3121.—Tips Included for Both Employee and Employer Taxes

Tips included for both employee and employer taxes. This ruling provides guidance for employers and employees in a question and answer format regarding taxes imposed on tips under the Federal Insurance Contributions Act (FICA), including information on the difference between tips and service charges, the reporting of the employer share of FICA under section 3121(q) of the Code, and the section 45B credit. See related Announcement 2012-25, published elsewhere in this Bulletin. Rev. Rul. 95-7 modified and superseded.

Rev. Rul. 2012-18

The purpose of this revenue ruling is to clarify and update guidelines first presented in Rev. Rul. 95-7, 1995-1 C.B. 185, concerning the taxes imposed on tips under the Federal Insurance Contributions Act (FICA) and the notice and demand under section 3121(q) of the Internal Revenue Code (Code).

Sections 3101 and 3111 of the Code impose FICA taxes on employees and employers, respectively, equal to a percentage of the wages received by an individual with respect to employment. FICA taxes consist of two separate taxes, the Old Age, Survivors, and Disability Insurance (social security) tax and the Hospital Insurance (Medicare) tax. The amount of wages subject to social security tax is limited by an annual contribution and benefit base; however, all wages are subject to Medicare tax.

Section 3121(a) of the Code defines “wages” for FICA tax purposes as all remuneration for employment, with certain exceptions. Section 3121(a)(12)(A) excludes from the definition of wages tips paid in any medium other than cash; section 3121(a)(12)(B) excludes cash tips received by an employee in any calendar month in the course of the employee’s employment by an employer unless the amount of the cash tips is \$20 or more.

Employer FICA Obligations. Under section 3121(q) of the Code, tips received

by an employee in the course of the employee’s employment are considered remuneration for that employment and are deemed to have been paid by the employer for purposes of the employer share of FICA taxes imposed by sections 3111(a) and (b), that is, social security tax and Medicare tax, respectively. The remuneration is deemed to be paid when a written statement including the tips is furnished to the employer by the employee pursuant to section 6053(a), discussed below.

Section 3111 of the Code requires the employer to pay social security tax on the amount of cash tips received by the employee up to and including the contribution and benefit base as determined under section 3121(a)(1) and to pay Medicare tax on the total amount of cash tips received by the employee. However, if the employee either did not furnish the statement pursuant to section 6053(a) or if the statement furnished was inaccurate or incomplete, in determining the employer’s liability in connection with the taxes imposed by section 3111 with respect to the tips, section 3121(q) provides that the remuneration is deemed, for purposes of subtitle F (Procedure and Administration), to be paid on the date on which notice and demand for the taxes is made to the employer by the Internal Revenue Service (Service).

Employee FICA Obligations. Under section 3121(q) of the Code, for purposes of the employee share of FICA taxes imposed by sections 3101(a) and (b), tips that are properly reported to the employer pursuant to section 6053(a) are deemed to be paid at the time a written statement is furnished to the employer pursuant to section 6053(a). Unreported tips received by the employee are deemed to be paid to the employee when actually received by the employee.

Section 6053(a) of the Code requires every employee who, in the course of the employee’s employment by an employer, receives in any calendar month tips that are wages (as defined in section 3121(a) for FICA tax purposes or section 3401(a) for income tax withholding purposes) to report all those tips in one or more written statements furnished to the employer on or before the 10th day of the follow-

ing month. The employee is to furnish the statements in the form and manner prescribed by the Service. See § 31.6053-1(b) of the Employment Tax Regulations.

Credit for Employer Share of FICA Taxes Paid. Section 45B(a) of the Code provides that, for purposes of the general business credit under section 38, the credit for employer social security and Medicare taxes paid on certain employee tips is an amount equal to the “excess employer social security tax” paid or incurred by the employer. The term “excess employer social security tax” means any tax paid by an employer under section 3111 (both social security tax and Medicare tax) on its employees’ tip income without regard to whether the employees reported the tips to the employer pursuant to section 6053(a). Consequently, the section 45B credit is available with respect to unreported tips in an amount equal to the “excess employer social security tax” paid or incurred by the employer. No credit, however, is allowed to the extent tips are used to meet the federal minimum wage rate. For purposes of this limitation, the federal minimum wage rate is the rate that was in effect on January 1, 2007. The credit is available with respect to FICA taxes paid on tips received from customers in connection with the providing, delivering, or serving of food or beverages for consumption, if it is customary for customers to tip the employees.

QUESTIONS AND ANSWERS

IN GENERAL

Q1. Is the characterization of a payment as a “tip” by the employer determinative for FICA tax purposes under section 3121 of the Code?

A1. No. The employer’s characterization of a payment as a “tip” is not determinative. For example, an employer may characterize a payment as a tip, when in fact the payment is a service charge. The criteria of Rev. Rul. 59-252, 1959-2 C.B. 215, should be applied to determine whether a payment made in the course of employment is a tip or non-tip wages under section 3121 of the Code. The revenue ruling provides that the absence of

any of the following factors creates a doubt as to whether a payment is a tip and indicates that the payment may be a service charge: (1) the payment must be made free from compulsion; (2) the customer must have the unrestricted right to determine the amount; (3) the payment should not be the subject of negotiation or dictated by employer policy; and (4) generally, the customer has the right to determine who receives the payment. All of the surrounding facts and circumstances must be considered. For example, Rev. Rul. 59-252 holds that the payment of a fixed charge imposed by a banquet hall that is distributed to the employees who render services (*e.g.*, waiter, busser, and bartender) is a service charge and not a tip. Thus, to the extent any portion of a service charge paid by a customer is distributed to an employee it is wages for FICA tax purposes.

The application of the factors is illustrated by the following two common examples:

Example A: Restaurant W's menu specifies that an 18% charge will be added to all bills for parties of 6 or more customers. Customer D's bill for food and beverages for her party of 8 includes an amount on the "tip line" equal to 18% of the price for food and beverages and the total includes this amount. Restaurant W distributes this amount to the waitresses and bussers. Under these circumstances, Customer D did not have the unrestricted right to determine the amount of the payment because it was dictated by employer policy. Customer D did not make the payment free from compulsion. The 18% charge is not a tip within the meaning of section 3121 of the Code. The amount included on the tip line is a service charge dictated by Restaurant W.

Example B: Restaurant X includes sample calculations of tip amounts beneath the signature line on its charge receipts for food and beverages provided to customers. The actual tip line is left blank. Customer G's charge receipt shows sample tip calculations of 15%, 18% and 20% of the price of food and beverages. Customer G inserts the amount calculated at 15% on the tip line and adds this amount to the price of food and beverages to compute the total. Under these circumstances, Customer G was free to enter any amount on the tip line or leave it blank; thus, Customer G entered the 15% amount free from compulsion. Customer G and Restaurant X did not negotiate the amount nor did Restaurant X dictate the amount. Customer G generally determined who would get the amount. The amount Customer G entered on the tip line is a tip within the meaning of section 3121 of the Code.

Q2. What tips must be reported to the employer?

A2. All cash tips received by an employee are wages for FICA tax purposes and, therefore, must be reported to the em-

ployer unless the cash tips received by the employee during a single calendar month while working for the employer total less than \$20. If an employee works for more than one employer during a month and receives less than \$20 in tips while working for each employer, no tips are required to be reported to any of the employers. Cash tips include tips received from customers, charged tips (*e.g.*, credit and debit card charges) distributed to the employee by his or her employer, and tips received from other employees under any tip-sharing arrangement. Thus, both directly and indirectly tipped employees must report tips received to their employer. Non-cash tips (*i.e.*, tips received by an employee in any other medium than cash, such as passes, tickets, or other goods or commodities) from customers are not wages for FICA tax purposes and are not reported to the employer. All cash tips and non-cash tips are includable in an employee's gross income and subject to federal income taxes.

Q3. How are tips reported by the employee to the employer?

A3. The employee must give the employer a written statement (or statements) of cash tips by the 10th day of the month after the month in which the tips are received. Form 4070, *Employee's Report of Tips to Employer*, is available for this purpose and may be found in Publication 1244, *Employee's Daily Record of Tips and Report to Employer*. The statement may be furnished on paper or transmitted electronically. See § 31.6053-1(b) of the regulations.

Q4. How are FICA taxes paid on tips which are reported to the employer by the employee?

A4. The employer withholds the employee share of FICA taxes on the reported tips from the wages of the employee (other than tips) or from other funds made available by the employee for this purpose. See section 3102(c) of the Code and §§ 31.3102-3 and 31.3402(k)-1(c) of the regulations. The employer pays both employer and employee shares of FICA taxes in the same manner as the taxes on the employee's non-tip wages and includes the reported tips on the employee's Form W-2, *Wage and Tax Statement*. The employer makes a current period adjustment on Form 941, *Employer's QUARTERLY Federal Tax Return*, to reflect any uncollected employee FICA taxes on reported

tips. The employer reports any uncollected employee FICA taxes on the employee's Form W-2, *Wage and Tax Statement*. The employee must report these amounts as additional tax on the employee's Form 1040, *U.S. Individual Income Tax Return* (or other applicable return in the Form 1040 series).

EMPLOYEE

Q5. If an employee fails to report tips to his or her employer, is the employee liable for the employee share of FICA taxes on those unreported tips?

A5. Yes. The employee is liable for the employee share of FICA taxes on the unreported tips. The employee pays his or her share of FICA taxes by completing Form 4137, *Social Security and Medicare Tax on Unreported Tip Income*, and filing it with Form 1040 (or other applicable return in the Form 1040 series) for the year in which the tips are actually received by the employee.

Q6. Which year's social security and Medicare rates and social security contribution and benefit base apply to compute the employee's FICA tax liability on unreported tips?

A6. The social security and Medicare rates and the social security contribution and benefit base applicable to the calendar year in which the tips were actually received apply to compute the employee's FICA tax liability. Form 4137 includes the applicable social security and Medicare rates and social security contribution and benefit base. The employer is not liable to withhold and pay the employee share of FICA taxes on the unreported tips.

Q7. Are employees who fail to report tips to their employers subject to a penalty?

A7. Yes. Under section 6652(b) of the Code, an employee who fails to report tips required to be reported to an employer is subject to a penalty equal to 50 percent of the employee share of FICA taxes on those tips, unless the employee can provide a satisfactory explanation showing that the failure was due to reasonable cause and not due to willful neglect. The explanation must be made in the form of a written statement setting forth all the facts alleged as a reasonable cause. This statement can be attached to the employee's Form 1040 (See Form 4137). If the statement is submitted in response to a notice regarding

a proposed penalty assessment, the statement must contain a declaration that it is made under the penalties of perjury.

EMPLOYER

Q8. If an employee fails to report tips to his or her employer, is the employer liable for the employee and employer shares of FICA taxes on those unreported tips?

A8. If an employee fails to report tips to his or her employer, the employer is not liable for the employer share of FICA taxes on the unreported tips until notice and demand for the taxes is made to the employer by the Service. The employer is not liable to withhold and pay the employee share of FICA taxes on the unreported tips.

Q9. How is notice and demand made under section 3121(q) of the Code?

A9. There is no specific form or procedure prescribed for a Section 3121(q) Notice and Demand. Notice and demand is made by the Service when it advises the employer in writing of the amount of tips received by an employee (or employees) who failed to report or underreported tips to the employer. Although no specific form is prescribed, a document will constitute a Section 3121(q) Notice and Demand if it (1) includes the words “notice and demand” and “section 3121(q),” (2) states the amount of tips received by the employee (or employees), and (3) states the period to which the tips relate. However, a document including such information will not constitute a Section 3121(q) Notice and Demand if it states that it is not a notice and demand.

Q10. How does an employer that files Form 941 report the section 3121(q) FICA tax liability after notice and demand is made?

A10. The employer reports the amount of the section 3121(q) FICA tax liability as a current period liability for FICA taxes on the employer’s Form 941 for the calendar quarter in which notice and demand is made. Employers should consult the Instructions for Form 941 to determine the correct line entry on Form 941. The employer must also include the amount of the section 3121(q) FICA tax liability on the appropriate line of the record of federal tax liability (Part 2 of Form 941 for a monthly depositor or Schedule B (Form 941) for a semi-weekly depositor) corresponding to

the date of the Section 3121(q) Notice and Demand.

Q11. Which year’s social security and Medicare rates and social security contribution and benefit base apply to compute the employer’s FICA tax liability on unreported tips?

A11. The social security and Medicare rates and the social security contribution and benefit base applicable to the calendar year in which the tips were actually received apply to compute the employer’s FICA tax liability. The Service will compute the employer’s liability, and include a calculation worksheet with the Section 3121(q) Notice and Demand.

Q12. If the Service determines that an employer’s employees have unreported tips and issues a Section 3121(q) Notice and Demand to the employer, what is the period of limitations for the Service to assess the employer share of FICA taxes?

A12. Generally, the period of limitations for assessment under section 6501 of the Code is 3 years after the due date of the return or the date the return was filed, whichever is later. However, section 6501(b)(2) provides that employment tax returns reporting FICA taxes for any period ending with or within a calendar year filed before April 15 of the succeeding calendar year are deemed filed on April 15 of such succeeding calendar year.

As a general rule, the Service must assess the employer FICA taxes on the unreported tips within 3 years after April 15 of the calendar year following the year in which the Section 3121(q) Notice and Demand is made. For example, if the notice and demand is dated December 31, 2012, the liability is required to be reported on Form 941 for the fourth quarter of 2012, due on January 31, 2013. If the employer timely files Form 941, the period of limitations for assessment ends on April 15, 2016.

However, if the employer did not file its Form 941 for the fourth quarter of 2012 before April 15 of the succeeding calendar year (April 15, 2013) and instead filed on May 10, 2013, the Service must assess the employer FICA taxes by May 10, 2016, the date 3 years after the date the return was filed.

If the employer files a false or fraudulent Form 941 for the quarter in which the liability is required to be reported or fails to file Form 941 for that quarter, the Service

can assess the additional employer FICA taxes on the unreported tips at any time.

These assessment periods apply whether or not the employer accurately reports the liability on Form 941 as required by Q&A 10 above.

Q13. Is the employer liable for interest on the employer’s FICA tax liability for unreported tips?

A13. Generally, no. If the employer pays the tax on or before the due date of the Form 941 for the quarter during which notice and demand is made, the employer is not liable for interest. If the employer does not pay the tax by the due date of the return, interest will accrue on the underpayment from the due date of the return.

Q14. Is the employer required to deposit FICA taxes due on the unreported tips shown on the Section 3121(q) Notice and Demand?

A14. Yes. The employer must make deposits pursuant to section 6302 of the Code and § 31.6302–1 of the regulations. For purposes of applying the deposit rules, the amount of employer FICA taxes shown on the Section 3121(q) Notice and Demand, is treated as employment taxes accumulated by the employer on the date the Section 3121(q) Notice and Demand is made, which is the date printed on the notice and demand document. The Service generally intends to notify an employer at least 30 calendar days in advance of the issuance of a Section 3121(q) Notice and Demand.

Q15. Is the section 45B credit, with respect to the tips reported on the Section 3121(q) Notice and Demand, available to the employer in the year the notice and demand is made or the year in which the unreported tips were received by the employee?

A15. The section 45B credit is applied to the taxable year that the “excess social security tax” amount is paid or incurred. The section 45B(b)(1) definition of “excess social security tax” is limited to tips that “are deemed to have been paid by the employer to the employee pursuant to section 3121(q).” Under this definition of “excess social security tax,” such tax cannot be paid or incurred prior to the time that the tip amounts are deemed to have been paid under section 3121(q), which occurs on the date on which notice and demand for the employer share of FICA taxes is made to the employer. Therefore, the section 45B credit is available to the employer in the

year the Section 3121(q) Notice and Demand is made and not the year in which the unreported tips were received by the employee. The credit is claimed on Form 8846, *Credit for Employer Social Security and Medicare Taxes Paid on Certain Employee Tips*.

EFFECT ON OTHER REVENUE RULING(S)

Rev. Rul. 95-7 is modified and superseded.

DRAFTING INFORMATION

The principal author of this revenue ruling is Linda L. Conway-Hataloski of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt & Government Entities). For further information regarding this revenue ruling, contact Linda L. Conway-Hataloski at 202-622-0047 (not a toll-free call).

Section 6621.—Determination of Rate of Interest

26 CFR 301.6621-1: *Interest rate.*

Interest rates; underpayments and overpayments. The rates for interest determined under section 6621 of the Code for the calendar quarter beginning July 1, 2012, will be 3 percent for overpayments (2 percent in the case of a corporation), 3 percent for the underpayments, and 5 percent for large corporate underpayments. The rate of interest paid on the portion of a corporate overpayment exceeding \$10,000 will be 0.5 percent.

Rev. Rul. 2012-16

Section 6621 of the Internal Revenue Code establishes the interest rates on overpayments and underpayments of tax. Under section 6621(a)(1), the overpayment rate is the sum of the federal short-term rate plus 3 percentage points (2 percentage points in the case of a corporation), ex-

cept the rate for the portion of a corporate overpayment of tax exceeding \$10,000 for a taxable period is the sum of the federal short-term rate plus 0.5 of a percentage point. Under section 6621(a)(2), the underpayment rate is the sum of the federal short-term rate plus 3 percentage points.

Section 6621(c) provides that for purposes of interest payable under section 6601 on any large corporate underpayment, the underpayment rate under section 6621(a)(2) is determined by substituting “5 percentage points” for “3 percentage points.” See section 6621(c) and section 301.6621-3 of the Regulations on Procedure and Administration for the definition of a large corporate underpayment and for the rules for determining the applicable date. Section 6621(c) and section 301.6621-3 are generally effective for periods after December 31, 1990.

Section 6621(b)(1) provides that the Secretary will determine the federal short-term rate for the first month in each calendar quarter. Section 6621(b)(2)(A) provides that the federal short-term rate determined under section 6621(b)(1) for any month applies during the first calendar quarter beginning after that month. Section 6621(b)(3) provides that the federal short-term rate for any month is the federal short-term rate determined during that month by the Secretary in accordance with section 1274(d), rounded to the nearest full percent (or, if a multiple of 1/2 of 1 percent, the rate is increased to the next highest full percent).

Notice 88-59, 1988-1 C.B. 546, announced that, in determining the quarterly interest rates to be used for overpayments and underpayments of tax under section 6621, the Internal Revenue Service will use the federal short-term rate based on daily compounding because that rate is most consistent with section 6621 which, pursuant to section 6622, is subject to daily compounding.

The federal short-term rate determined in accordance with section 1274(d) during April 2012 is the rate published in

Revenue Ruling 2012-13, 2012-19 I.R.B. 878, to take effect beginning May 1, 2012. The federal short-term rate, rounded to the nearest full percent, based on daily compounding determined during the month of April 2012 is 0 percent. Accordingly, an overpayment rate of 3 percent (2 percent in the case of a corporation) and an underpayment rate of 3 percent are established for the calendar quarter beginning July 1, 2012. The overpayment rate for the portion of a corporate overpayment exceeding \$10,000 for the calendar quarter beginning July 1, 2012, is 0.5 percent. The underpayment rate for large corporate underpayments for the calendar quarter beginning July 1, 2012, is 5 percent. These rates apply to amounts bearing interest during that calendar quarter.

The 3 percent rate also applies to estimated tax underpayments for the third calendar quarter in 2012.

Interest factors for daily compound interest for annual rates of 0.5 percent are published in Appendix A of this Revenue Ruling. Interest factors for daily compound interest for annual rates of 2 percent, 3 percent and 5 percent are published in Tables 57, 59, and 63 of Rev. Proc. 95-17, 1995-1 C.B. 611, 613, and 617.

Annual interest rates to be compounded daily pursuant to section 6622 that apply for prior periods are set forth in the tables accompanying this revenue ruling.

DRAFTING INFORMATION

The principal author of this revenue ruling is A.M. Gulas of the Office of Associate Chief Counsel (Procedure & Administration). For further information regarding this revenue ruling, contact Ms. Gulas at (202) 622-4570 (not a toll-free call).

APPENDIX A

365 Day Year					
0.5% Compound Rate 184 Days					
Days	Factor	Days	Factor	Days	Factor
1	0.000013699	63	0.000863380	125	0.001713784
2	0.000027397	64	0.000877091	126	0.001727506
3	0.000041096	65	0.000890801	127	0.001741228
4	0.000054796	66	0.000904512	128	0.001754951
5	0.000068495	67	0.000918223	129	0.001768673
6	0.000082195	68	0.000931934	130	0.001782396
7	0.000095894	69	0.000945646	131	0.001796119
8	0.000109594	70	0.000959357	132	0.001809843
9	0.000123294	71	0.000973069	133	0.001823566
10	0.000136995	72	0.000986781	134	0.001837290
11	0.000150695	73	0.001000493	135	0.001851013
12	0.000164396	74	0.001014206	136	0.001864737
13	0.000178097	75	0.001027918	137	0.001878462
14	0.000191798	76	0.001041631	138	0.001892186
15	0.000205499	77	0.001055344	139	0.001905910
16	0.000219201	78	0.001069057	140	0.001919635
17	0.000232902	79	0.001082770	141	0.001933360
18	0.000246604	80	0.001096484	142	0.001947085
19	0.000260306	81	0.001110197	143	0.001960811
20	0.000274008	82	0.001123911	144	0.001974536
21	0.000287711	83	0.001137625	145	0.001988262
22	0.000301413	84	0.001151339	146	0.002001988
23	0.000315116	85	0.001165054	147	0.002015714
24	0.000328819	86	0.001178768	148	0.002029440
25	0.000342522	87	0.001192483	149	0.002043166
26	0.000356225	88	0.001206198	150	0.002056893
27	0.000369929	89	0.001219913	151	0.002070620
28	0.000383633	90	0.001233629	152	0.002084347
29	0.000397336	91	0.001247344	153	0.002098074
30	0.000411041	92	0.001261060	154	0.002111801
31	0.000424745	93	0.001274776	155	0.002125529
32	0.000438449	94	0.001288492	156	0.002139257
33	0.000452154	95	0.001302208	157	0.002152985
34	0.000465859	96	0.001315925	158	0.002166713
35	0.000479564	97	0.001329641	159	0.002180441
36	0.000493269	98	0.001343358	160	0.002194169
37	0.000506974	99	0.001357075	161	0.002207898
38	0.000520680	100	0.001370792	162	0.002221627
39	0.000534386	101	0.001384510	163	0.002235356
40	0.000548092	102	0.001398227	164	0.002249085
41	0.000561798	103	0.001411945	165	0.002262815
42	0.000575504	104	0.001425663	166	0.002276544
43	0.000589211	105	0.001439381	167	0.002290274
44	0.000602917	106	0.001453100	168	0.002304004
45	0.000616624	107	0.001466818	169	0.002317734
46	0.000630331	108	0.001480537	170	0.002331465
47	0.000644039	109	0.001494256	171	0.002345195
48	0.000657746	110	0.001507975	172	0.002358926
49	0.000671454	111	0.001521694	173	0.002372657
50	0.000685161	112	0.001535414	174	0.002386388
51	0.000698869	113	0.001549133	175	0.002400120
52	0.000712578	114	0.001562853	176	0.002413851
53	0.000726286	115	0.001576573	177	0.002427583
54	0.000739995	116	0.001590293	178	0.002441315
55	0.000753703	117	0.001604014	179	0.002455047
56	0.000767412	118	0.001617734	180	0.002468779

365 Day Year

0.5% Compound Rate 184 Days – Continued

Days	Factor	Days	Factor	Days	Factor
57	0.000781121	119	0.001631455	181	0.002482511
58	0.000794831	120	0.001645176	182	0.002496244
59	0.000808540	121	0.001658897	183	0.002509977
60	0.000822250	122	0.001672619	184	0.002523710
61	0.000835960	123	0.001686340		
62	0.000849670	124	0.001700062		

365 Day Year

0.5% Compound Rate 184 Days

Days	Factor	Days	Factor	Days	Factor
1	0.000013661	63	0.000861020	125	0.001709097
2	0.000027323	64	0.000874693	126	0.001722782
3	0.000040984	65	0.000888366	127	0.001736467
4	0.000054646	66	0.000902040	128	0.001750152
5	0.000068308	67	0.000915713	129	0.001763837
6	0.000081970	68	0.000929387	130	0.001777522
7	0.000095632	69	0.000943061	131	0.001791208
8	0.000109295	70	0.000956735	132	0.001804893
9	0.000122958	71	0.000970409	133	0.001818579
10	0.000136620	72	0.000984084	134	0.001832265
11	0.000150283	73	0.000997758	135	0.001845951
12	0.000163947	74	0.001011433	136	0.001859638
13	0.000177610	75	0.001025108	137	0.001873324
14	0.000191274	76	0.001038783	138	0.001887011
15	0.000204938	77	0.001052459	139	0.001900698
16	0.000218602	78	0.001066134	140	0.001914385
17	0.000232266	79	0.001079810	141	0.001928073
18	0.000245930	80	0.001093486	142	0.001941760
19	0.000259595	81	0.001107162	143	0.001955448
20	0.000273260	82	0.001120839	144	0.001969136
21	0.000286924	83	0.001134515	145	0.001982824
22	0.000300590	84	0.001148192	146	0.001996512
23	0.000314255	85	0.001161869	147	0.002010201
24	0.000327920	86	0.001175546	148	0.002023889
25	0.000341586	87	0.001189223	149	0.002037578
26	0.000355252	88	0.001202900	150	0.002051267
27	0.000368918	89	0.001216578	151	0.002064957
28	0.000382584	90	0.001230256	152	0.002078646
29	0.000396251	91	0.001243934	153	0.002092336
30	0.000409917	92	0.001257612	154	0.002106025
31	0.000423584	93	0.001271291	155	0.002119715
32	0.000437251	94	0.001284969	156	0.002133405
33	0.000450918	95	0.001298648	157	0.002147096
34	0.000464586	96	0.001312327	158	0.002160786
35	0.000478253	97	0.001326006	159	0.002174477
36	0.000491921	98	0.001339685	160	0.002188168
37	0.000505589	99	0.001353365	161	0.002201859
38	0.000519257	100	0.001367044	162	0.002215550
39	0.000532925	101	0.001380724	163	0.002229242
40	0.000546594	102	0.001394404	164	0.002242933
41	0.000560262	103	0.001408085	165	0.002256625
42	0.000573931	104	0.001421765	166	0.002270317
43	0.000587600	105	0.001435446	167	0.002284010
44	0.000601269	106	0.001449127	168	0.002297702
45	0.000614939	107	0.001462808	169	0.002311395

365 Day Year

0.5% Compound Rate 184 Days – Continued

Days	Factor	Days	Factor	Days	Factor
46	0.000628608	108	0.001476489	170	0.002325087
47	0.000642278	109	0.001490170	171	0.002338780
48	0.000655948	110	0.001503852	172	0.002352473
49	0.000669618	111	0.001517533	173	0.002366167
50	0.000683289	112	0.001531215	174	0.002379860
51	0.000696959	113	0.001544897	175	0.002393554
52	0.000710630	114	0.001558580	176	0.002407248
53	0.000724301	115	0.001572262	177	0.002420942
54	0.000737972	116	0.001585945	178	0.002434636
55	0.000751643	117	0.001599628	179	0.002448331
56	0.000765315	118	0.001613311	180	0.002462025
57	0.000778986	119	0.001626994	181	0.002475720
58	0.000792658	120	0.001640678	182	0.002489415
59	0.000806330	121	0.001654361	183	0.002503110
60	0.000820003	122	0.001668045	184	0.002516806
61	0.000833675	123	0.001681729		
62	0.000847348	124	0.001695413		

TABLE OF INTEREST RATES

PERIODS BEFORE JUL. 1, 1975 — PERIODS ENDING DEC. 31, 1986

OVERPAYMENTS AND UNDERPAYMENTS

PERIOD	RATE	In 1995-1 C.B.
		DAILY RATE TABLE
Before Jul. 1, 1975	6%	Table 2, pg. 557
Jul. 1, 1975—Jan. 31, 1976	9%	Table 4, pg. 559
Feb. 1, 1976—Jan. 31, 1978	7%	Table 3, pg. 558
Feb. 1, 1978—Jan. 31, 1980	6%	Table 2, pg. 557
Feb. 1, 1980—Jan. 31, 1982	12%	Table 5, pg. 560
Feb. 1, 1982—Dec. 31, 1982	20%	Table 6, pg. 560
Jan. 1, 1983—Jun. 30, 1983	16%	Table 37, pg. 591
Jul. 1, 1983—Dec. 31, 1983	11%	Table 27, pg. 581
Jan. 1, 1984—Jun. 30, 1984	11%	Table 75, pg. 629
Jul. 1, 1984—Dec. 31, 1984	11%	Table 75, pg. 629
Jan. 1, 1985—Jun. 30, 1985	13%	Table 31, pg. 585
Jul. 1, 1985—Dec. 31, 1985	11%	Table 27, pg. 581
Jan. 1, 1986—Jun. 30, 1986	10%	Table 25, pg. 579
Jul. 1, 1986—Dec. 31, 1986	9%	Table 23, pg. 577

TABLE OF INTEREST RATES

FROM JAN. 1, 1987 — DEC. 31, 1988

	OVERPAYMENTS			UNDERPAYMENTS		
	1995-1 C.B.			1995-1 C.B.		
	RATE	TABLE	PG	RATE	TABLE	PG
Jan. 1, 1987—Mar. 31, 1987	8%	21	575	9%	23	577
Apr. 1, 1987—Jun. 30, 1987	8%	21	575	9%	23	577
Jul. 1, 1987—Sep. 30, 1987	8%	21	575	9%	23	577
Oct. 1, 1987—Dec. 31, 1987	9%	23	577	10%	25	579
Jan. 1, 1988—Mar. 31, 1988	10%	73	627	11%	75	629
Apr. 1, 1988—Jun. 30, 1988	9%	71	625	10%	73	627
Jul. 1, 1988—Sep. 30, 1988	9%	71	625	10%	73	627

TABLE OF INTEREST RATES
FROM JAN. 1, 1987 — DEC. 31, 1998 – Continued

	OVERPAYMENTS			UNDERPAYMENTS		
	1995-1 C.B.			1995-1 C.B.		
	RATE	TABLE	PG	RATE	TABLE	PG
Oct. 1, 1988—Dec. 31, 1988	10%	73	627	11%	75	629
Jan. 1, 1989—Mar. 31, 1989	10%	25	579	11%	27	581
Apr. 1, 1989—Jun. 30, 1989	11%	27	581	12%	29	583
Jul. 1, 1989—Sep. 30, 1989	11%	27	581	12%	29	583
Oct. 1, 1989—Dec. 31, 1989	10%	25	579	11%	27	581
Jan. 1, 1990—Mar. 31, 1990	10%	25	579	11%	27	581
Apr. 1, 1990—Jun. 30, 1990	10%	25	579	11%	27	581
Jul. 1, 1990—Sep. 30, 1990	10%	25	579	11%	27	581
Oct. 1, 1990—Dec. 31, 1990	10%	25	579	11%	27	581
Jan. 1, 1991—Mar. 31, 1991	10%	25	579	11%	27	581
Apr. 1, 1991—Jun. 30, 1991	9%	23	577	10%	25	579
Jul. 1, 1991—Sep. 30, 1991	9%	23	577	10%	25	579
Oct. 1, 1991—Dec. 31, 1991	9%	23	577	10%	25	579
Jan. 1, 1992—Mar. 31, 1992	8%	69	623	9%	71	625
Apr. 1, 1992—Jun. 30, 1992	7%	67	621	8%	69	623
Jul. 1, 1992—Sep. 30, 1992	7%	67	621	8%	69	623
Oct. 1, 1992—Dec. 31, 1992	6%	65	619	7%	67	621
Jan. 1, 1993—Mar. 31, 1993	6%	17	571	7%	19	573
Apr. 1, 1993—Jun. 30, 1993	6%	17	571	7%	19	573
Jul. 1, 1993—Sep. 30, 1993	6%	17	571	7%	19	573
Oct. 1, 1993—Dec. 31, 1993	6%	17	571	7%	19	573
Jan. 1, 1994—Mar. 31, 1994	6%	17	571	7%	19	573
Apr. 1, 1994—Jun. 30, 1994	6%	17	571	7%	19	573
Jul. 1, 1994—Sep. 30, 1994	7%	19	573	8%	21	575
Oct. 1, 1994—Dec. 31, 1994	8%	21	575	9%	23	577
Jan. 1, 1995—Mar. 31, 1995	8%	21	575	9%	23	577
Apr. 1, 1995—Jun. 30, 1995	9%	23	577	10%	25	579
Jul. 1, 1995—Sep. 30, 1995	8%	21	575	9%	23	577
Oct. 1, 1995—Dec. 31, 1995	8%	21	575	9%	23	577
Jan. 1, 1996—Mar. 31, 1996	8%	69	623	9%	71	625
Apr. 1, 1996—Jun. 30, 1996	7%	67	621	8%	69	623
Jul. 1, 1996—Sep. 30, 1996	8%	69	623	9%	71	625
Oct. 1, 1996—Dec. 31, 1996	8%	69	623	9%	71	625
Jan. 1, 1997—Mar. 31, 1997	8%	21	575	9%	23	577
Apr. 1, 1997—Jun. 30, 1997	8%	21	575	9%	23	577
Jul. 1, 1997—Sep. 30, 1997	8%	21	575	9%	23	577
Oct. 1, 1997—Dec. 31, 1997	8%	21	575	9%	23	577
Jan. 1, 1998—Mar. 31, 1998	8%	21	575	9%	23	577
Apr. 1, 1998—Jun. 30, 1998	7%	19	573	8%	21	575
Jul. 1, 1998—Sep. 30, 1998	7%	19	573	8%	21	575
Oct. 1, 1998—Dec. 31, 1998	7%	19	573	8%	21	575

TABLE OF INTEREST RATES
FROM JANUARY 1, 1999 — PRESENT
NONCORPORATE OVERPAYMENTS AND UNDERPAYMENTS

	1995-1 C.B.		
	RATE	TABLE	PG
Jan. 1, 1999—Mar. 31, 1999	7%	19	573
Apr. 1, 1999—Jun. 30, 1999	8%	21	575
Jul. 1, 1999—Sep. 30, 1999	8%	21	575
Oct. 1, 1999—Dec. 31, 1999	8%	21	575
Jan. 1, 2000—Mar. 31, 2000	8%	69	623

TABLE OF INTEREST RATES
 FROM JANUARY 1, 1999 — PRESENT — Continued
 NONCORPORATE OVERPAYMENTS AND UNDERPAYMENTS

	RATE	1995-1 C.B. TABLE	PG
Apr. 1, 2000—Jun. 30, 2000	9%	71	625
Jul. 1, 2000—Sep. 30, 2000	9%	71	625
Oct. 1, 2000—Dec. 31, 2000	9%	71	625
Jan. 1, 2001—Mar. 31, 2001	9%	23	577
Apr. 1, 2001—Jun. 30, 2001	8%	21	575
Jul. 1, 2001—Sep. 30, 2001	7%	19	573
Oct. 1, 2001—Dec. 31, 2001	7%	19	573
Jan. 1, 2002—Mar. 31, 2002	6%	17	571
Apr. 1, 2002—Jun. 30, 2002	6%	17	571
Jul. 1, 2002—Sep. 30, 2002	6%	17	571
Oct. 1, 2002—Dec. 31, 2002	6%	17	571
Jan. 1, 2003—Mar. 31, 2003	5%	15	569
Apr. 1, 2003—Jun. 30, 2003	5%	15	569
Jul. 1, 2003—Sep. 30, 2003	5%	15	569
Oct. 1, 2003—Dec. 31, 2003	4%	13	567
Jan. 1, 2004—Mar. 31, 2004	4%	61	615
Apr. 1, 2004—Jun. 30, 2004	5%	63	617
Jul. 1, 2004—Sep. 30, 2004	4%	61	615
Oct. 1, 2004—Dec. 31, 2004	5%	63	617
Jan. 1, 2005—Mar. 31, 2005	5%	15	569
Apr. 1, 2005—Jun. 30, 2005	6%	17	571
Jul. 1, 2005—Sep. 30, 2005	6%	17	571
Oct. 1, 2005—Dec. 31, 2005	7%	19	573
Jan. 1, 2006—Mar. 31, 2006	7%	19	573
Apr. 1, 2006—Jun. 30, 2006	7%	19	573
Jul. 1, 2006—Sep. 30, 2006	8%	21	575
Oct. 1, 2006—Dec. 31, 2006	8%	21	575
Jan. 1, 2007—Mar. 31, 2007	8%	21	575
Apr. 1, 2007—Jun. 30, 2007	8%	21	575
Jul. 1, 2007—Sep. 30, 2007	8%	21	575
Oct. 1, 2007—Dec. 31, 2007	8%	21	575
Jan. 1, 2008—Mar. 31, 2008	7%	67	621
Apr. 1, 2008—Jun. 30, 2008	6%	65	619
Jul. 1, 2008—Sep. 30, 2008	5%	63	617
Oct. 1, 2008—Dec. 31, 2008	6%	65	619
Jan. 1, 2009—Mar. 31, 2009	5%	15	569
Apr. 1, 2009—Jun. 30, 2009	4%	13	567
Jul. 1, 2009—Sep. 30, 2009	4%	13	567
Oct. 1, 2009—Dec. 31, 2009	4%	13	567
Jan. 1, 2010—Mar. 31, 2010	4%	13	567
Apr. 1, 2010—Jun. 30, 2010	4%	13	567
Jul. 1, 2010—Sep. 30, 2010	4%	13	567
Oct. 1, 2010—Dec. 31, 2010	4%	13	567
Jan. 1, 2011—Mar. 31, 2011	3%	11	565
Apr. 1, 2011—Jun. 30, 2011	4%	13	567
Jul. 1, 2011—Sep. 30, 2011	4%	13	567
Oct. 1, 2011—Dec. 31, 2011	3%	11	565
Jan. 1, 2012—Mar. 31, 2012	3%	59	613
Apr. 1, 2012—Jun. 30, 2012	3%	59	613
Jul. 1, 2012—Sep. 30, 2012	3%	59	613

TABLE OF INTEREST RATES
FROM JANUARY 1, 1999 — PRESENT
CORPORATE OVERPAYMENTS AND UNDERPAYMENTS

	OVERPAYMENTS			UNDERPAYMENTS		
	1995-1 C.B.			1995-1 C.B.		
	RATE	TABLE	PG	RATE	TABLE	PG
Jan. 1, 1999—Mar. 31, 1999	6%	17	571	7%	19	573
Apr. 1, 1999—Jun. 30, 1999	7%	19	573	8%	21	575
Jul. 1, 1999—Sep. 30, 1999	7%	19	573	8%	21	575
Oct. 1, 1999—Dec. 31, 1999	7%	19	573	8%	21	575
Jan. 1, 2000—Mar. 31, 2000	7%	67	621	8%	69	623
Apr. 1, 2000—Jun. 30, 2000	8%	69	623	9%	71	625
Jul. 1, 2000—Sep. 30, 2000	8%	69	623	9%	71	625
Oct. 1, 2000—Dec. 31, 2000	8%	69	623	9%	71	625
Jan. 1, 2001—Mar. 31, 2001	8%	21	575	9%	23	577
Apr. 1, 2001—Jun. 30, 2001	7%	19	573	8%	21	575
Jul. 1, 2001—Sep. 30, 2001	6%	17	571	7%	19	573
Oct. 1, 2001—Dec. 31, 2001	6%	17	571	7%	19	573
Jan. 1, 2002—Mar. 31, 2002	5%	15	569	6%	17	571
Apr. 1, 2002—Jun. 30, 2002	5%	15	569	6%	17	571
Jul. 1, 2002—Sep. 30, 2002	5%	15	569	6%	17	571
Oct. 1, 2002—Dec. 31, 2002	5%	15	569	6%	17	571
Jan. 1, 2003—Mar. 31, 2003	4%	13	567	5%	15	569
Apr. 1, 2003—Jun. 30, 2003	4%	13	567	5%	15	569
Jul. 1, 2003—Sep. 30, 2003	4%	13	567	5%	15	569
Oct. 1, 2003—Dec. 31, 2003	3%	11	565	4%	13	567
Jan. 1, 2004—Mar. 31, 2004	3%	59	613	4%	61	615
Apr. 1, 2004—Jun. 30, 2004	4%	61	615	5%	63	617
Jul. 1, 2004—Sep. 30, 2004	3%	59	613	4%	61	615
Oct. 1, 2004—Dec. 31, 2004	4%	61	615	5%	63	617
Jan. 1, 2005—Mar. 31, 2005	4%	13	567	5%	15	569
Apr. 1, 2005—Jun. 30, 2005	5%	15	569	6%	17	571
Jul. 1, 2005—Sep. 30, 2005	5%	15	569	6%	17	571
Oct. 1, 2005—Dec. 31, 2005	6%	17	571	7%	19	573
Jan. 1, 2006—Mar. 31, 2006	6%	17	571	7%	19	573
Apr. 1, 2006—Jun. 30, 2006	6%	17	571	7%	19	573
Jul. 1, 2006—Sep. 30, 2006	7%	19	573	8%	21	575
Oct. 1, 2006—Dec. 31, 2006	7%	19	573	8%	21	575
Jan. 1, 2007—Mar. 31, 2007	7%	19	573	8%	21	575
Apr. 1, 2007—Jun. 30, 2007	7%	19	573	8%	21	575
Jul. 1, 2007—Sep. 30, 2007	7%	19	573	8%	21	575
Oct. 1, 2007—Dec. 31, 2007	7%	19	573	8%	21	575
Jan. 1, 2008—Mar. 31, 2008	6%	65	619	7%	67	621
Apr. 1, 2008—Jun. 30, 2008	5%	63	617	6%	65	619
Jul. 1, 2008—Sep. 30, 2008	4%	61	615	5%	63	617
Oct. 1, 2008—Dec. 31, 2008	5%	63	617	6%	65	619
Jan. 1, 2009—Mar. 31, 2009	4%	13	567	5%	15	569
Apr. 1, 2009—Jun. 30, 2009	3%	11	565	4%	13	567
Jul. 1, 2009—Sep. 30, 2009	3%	11	565	4%	13	567
Oct. 1, 2009—Dec. 31, 2009	3%	11	565	4%	13	567
Jan. 1, 2010—Mar. 31, 2010	3%	11	565	4%	13	567
Apr. 1, 2010—Jun. 30, 2010	3%	11	565	4%	13	567
Jul. 1, 2010—Sep. 30, 2010	3%	11	565	4%	13	567
Oct. 1, 2010—Dec. 31, 2010	3%	11	565	4%	13	567
Jan. 1, 2011—Mar. 31, 2011	2%	9	563	3%	11	565
Apr. 1, 2011—Jun. 30, 2011	3%	11	565	4%	13	567
Jul. 1, 2011—Sep. 30, 2011	3%	11	565	4%	13	567
Oct. 1, 2011—Dec. 31, 2011	2%	9	563	3%	11	565
Jan. 1, 2012—Mar. 31, 2012	2%	57	611	3%	59	613

TABLE OF INTEREST RATES
FROM JANUARY 1, 1999 — PRESENT – Continued
CORPORATE OVERPAYMENTS AND UNDERPAYMENTS

	OVERPAYMENTS			UNDERPAYMENTS		
	1995-1 C.B.			1995-1 C.B.		
	RATE	TABLE	PG	RATE	TABLE	PG
Apr. 1, 2012—Jun. 30, 2012	2%	57	611	3%	59	613
Jul. 1, 2012—Sep. 30, 2012	2%	57	611	3%	59	613

TABLE OF INTEREST RATES FOR
LARGE CORPORATE UNDERPAYMENTS
FROM JANUARY 1, 1991 — PRESENT

	RATE	1995-1 C.B. TABLE	PG
Jan. 1, 1991—Mar. 31, 1991	13%	31	585
Apr. 1, 1991—Jun. 30, 1991	12%	29	583
Jul. 1, 1991—Sep. 30, 1991	12%	29	583
Oct. 1, 1991—Dec. 31, 1991	12%	29	583
Jan. 1, 1992—Mar. 31, 1992	11%	75	629
Apr. 1, 1992—Jun. 30, 1992	10%	73	627
Jul. 1, 1992—Sep. 30, 1992	10%	73	627
Oct. 1, 1992—Dec. 31, 1992	9%	71	625
Jan. 1, 1993—Mar. 31, 1993	9%	23	577
Apr. 1, 1993—Jun. 30, 1993	9%	23	577
Jul. 1, 1993—Sep. 30, 1993	9%	23	577
Oct. 1, 1993—Dec. 31, 1993	9%	23	577
Jan. 1, 1994—Mar. 31, 1994	9%	23	577
Apr. 1, 1994—Jun. 30, 1994	9%	23	577
Jul. 1, 1994—Sep. 30, 1994	10%	25	579
Oct. 1, 1994—Dec. 31, 1994	11%	27	581
Jan. 1, 1995—Mar. 31, 1995	11%	27	581
Apr. 1, 1995—Jun. 30, 1995	12%	29	583
Jul. 1, 1995—Sep. 30, 1995	11%	27	581
Oct. 1, 1995—Dec. 31, 1995	11%	27	581
Jan. 1, 1996—Mar. 31, 1996	11%	75	629
Apr. 1, 1996—Jun. 30, 1996	10%	73	627
Jul. 1, 1996—Sep. 30, 1996	11%	75	629
Oct. 1, 1996—Dec. 31, 1996	11%	75	629
Jan. 1, 1997—Mar. 31, 1997	11%	27	581
Apr. 1, 1997—Jun. 30, 1997	11%	27	581
Jul. 1, 1997—Sep. 30, 1997	11%	27	581
Oct. 1, 1997—Dec. 31, 1997	11%	27	581
Jan. 1, 1998—Mar. 31, 1998	11%	27	581
Apr. 1, 1998—Jun. 30, 1998	10%	25	579
Jul. 1, 1998—Sep. 30, 1998	10%	25	579
Oct. 1, 1998—Dec. 31, 1998	10%	25	579
Jan. 1, 1999—Mar. 31, 1999	9%	23	577
Apr. 1, 1999—Jun. 30, 1999	10%	25	579
Jul. 1, 1999—Sep. 30, 1999	10%	25	579
Oct. 1, 1999—Dec. 31, 1999	10%	25	579
Jan. 1, 2000—Mar. 31, 2000	10%	73	627
Apr. 1, 2000—Jun. 30, 2000	11%	75	629
Jul. 1, 2000—Sep. 30, 2000	11%	75	629
Oct. 1, 2000—Dec. 31, 2000	11%	75	629
Jan. 1, 2001—Mar. 31, 2001	11%	27	581
Apr. 1, 2001—Jun. 30, 2001	10%	25	579
Jul. 1, 2001—Sep. 30, 2001	9%	23	577

TABLE OF INTEREST RATES FOR
LARGE CORPORATE UNDERPAYMENTS
FROM JANUARY 1, 1991 — PRESENT — Continued

	RATE	1995-1 C.B. TABLE	PG
Oct. 1, 2001—Dec. 31, 2001	9%	23	577
Jan. 1, 2002—Mar. 31, 2002	8%	21	575
Apr. 1, 2002—Jun. 30, 2002	8%	21	575
Jul. 1, 2002—Sep. 30, 2002	8%	21	575
Oct. 1, 2002—Dec. 30, 2002	8%	21	575
Jan. 1, 2003—Mar. 31, 2003	7%	19	573
Apr. 1, 2003—Jun. 30, 2003	7%	19	573
Jul. 1, 2003—Sep. 30, 2003	7%	19	573
Oct. 1, 2003—Dec. 31, 2003	6%	17	571
Jan. 1, 2004—Mar. 31, 2004	6%	65	619
Apr. 1, 2004—Jun. 30, 2004	7%	67	621
Jul. 1, 2004—Sep. 30, 2004	6%	65	619
Oct. 1, 2004—Dec. 31, 2004	7%	67	621
Jan. 1, 2005—Mar. 31, 2005	7%	19	573
Apr. 1, 2005—Jun. 30, 2005	8%	21	575
Jul. 1, 2005—Sep. 30, 2005	8%	21	575
Oct. 1, 2005—Dec. 31, 2005	9%	23	577
Jan. 1, 2006—Mar. 31, 2006	9%	23	577
Apr. 1, 2006—Jun. 30, 2006	9%	23	577
Jul. 1, 2006—Sep. 30, 2006	10%	25	579
Oct. 1, 2006—Dec. 31, 2006	10%	25	579
Jan. 1, 2007—Mar. 31, 2007	10%	25	579
Apr. 1, 2007—Jun. 30, 2007	10%	25	579
Jul. 1, 2007—Sep. 30, 2007	10%	25	579
Oct. 1, 2007—Dec. 31, 2007	10%	25	579
Jan. 1, 2008—Mar. 31, 2008	9%	71	625
Apr. 1, 2008—Jun. 30, 2008	8%	69	623
Jul. 1, 2008—Sep. 30, 2008	7%	67	621
Oct. 1, 2008—Dec. 31, 2008	8%	69	623
Jan. 1, 2009—Mar. 31, 2009	7%	19	573
Apr. 1, 2009—Jun. 30, 2009	6%	17	571
Jul. 1, 2009—Sep. 30, 2009	6%	17	571
Oct. 1, 2009—Dec. 31, 2009	6%	17	571
Jan. 1, 2010—Mar. 31, 2010	6%	17	571
Apr. 1, 2010—Jun. 30, 2010	6%	17	571
Jul. 1, 2010—Sep. 30, 2010	6%	17	571
Oct. 1, 2010—Dec. 31, 2010	6%	17	571
Jan. 1, 2011—Mar. 31, 2011	5%	15	569
Apr. 1, 2011—Jun. 30, 2011	6%	17	571
Jul. 1, 2011—Sep. 30, 2011	6%	17	571
Oct. 1, 2011—Dec. 31, 2011	5%	15	569
Jan. 1, 2012—Mar. 31, 2012	5%	63	617
Apr. 1, 2012—Jun. 30, 2012	5%	63	617
Jul. 1, 2012—Sep. 30, 2012	5%	63	617

TABLE OF INTEREST RATES FOR CORPORATE
OVERPAYMENTS EXCEEDING \$10,000
FROM JANUARY 1, 1995 — PRESENT

	RATE	1995-1 C.B. TABLE	PG
Jan. 1, 1995—Mar. 31, 1995	6.5%	18	572
Apr. 1, 1995—Jun. 30, 1995	7.5%	20	574

TABLE OF INTEREST RATES FOR CORPORATE
OVERPAYMENTS EXCEEDING \$10,000
FROM JANUARY 1, 1995 — PRESENT — Continued

	RATE	1995-1 C.B. TABLE	PG
Jul. 1, 1995—Sep. 30, 1995	6.5%	18	572
Oct. 1, 1995—Dec. 31, 1995	6.5%	18	572
Jan. 1, 1996—Mar. 31, 1996	6.5%	66	620
Apr. 1, 1996—Jun. 30, 1996	5.5%	64	618
Jul. 1, 1996—Sep. 30, 1996	6.5%	66	620
Oct. 1, 1996—Dec. 31, 1996	6.5%	66	620
Jan. 1, 1997—Mar. 31, 1997	6.5%	18	572
Apr. 1, 1997—Jun. 30, 1997	6.5%	18	572
Jul. 1, 1997—Sep. 30, 1997	6.5%	18	572
Oct. 1, 1997—Dec. 31, 1997	6.5%	18	572
Jan. 1, 1998—Mar. 31, 1998	6.5%	18	572
Apr. 1, 1998—Jun. 30, 1998	5.5%	16	570
Jul. 1, 1998—Sep. 30, 1998	5.5%	16	570
Oct. 1, 1998—Dec. 31, 1998	5.5%	16	570
Jan. 1, 1999—Mar. 31, 1999	4.5%	14	568
Apr. 1, 1999—Jun. 30, 1999	5.5%	16	570
Jul. 1, 1999—Sep. 30, 1999	5.5%	16	570
Oct. 1, 1999—Dec. 31, 1999	5.5%	16	570
Jan. 1, 2000—Mar. 31, 2000	5.5%	64	618
Apr. 1, 2000—Jun. 30, 2000	6.5%	66	620
Jul. 1, 2000—Sep. 30, 2000	6.5%	66	620
Oct. 1, 2000—Dec. 31, 2000	6.5%	66	620
Jan. 1, 2001—Mar. 31, 2001	6.5%	18	572
Apr. 1, 2001—Jun. 30, 2001	5.5%	16	570
Jul. 1, 2001—Sep. 30, 2001	4.5%	14	568
Oct. 1, 2001—Dec. 31, 2001	4.5%	14	568
Jan. 1, 2002—Mar. 31, 2002	3.5%	12	566
Apr. 1, 2002—Jun. 30, 2002	3.5%	12	566
Jul. 1, 2002—Sep. 30, 2002	3.5%	12	566
Oct. 1, 2002—Dec. 31, 2002	3.5%	12	566
Jan. 1, 2003—Mar. 31, 2003	2.5%	10	564
Apr. 1, 2003—Jun. 30, 2003	2.5%	10	564
Jul. 1, 2003—Sep. 30, 2003	2.5%	10	564
Oct. 1, 2003—Dec. 31, 2003	1.5%	8	562
Jan. 1, 2004—Mar. 31, 2004	1.5%	56	610
Apr. 1, 2004—Jun. 30, 2004	2.5%	58	612
Jul. 1, 2004—Sep. 30, 2004	1.5%	56	610
Oct. 1, 2004—Dec. 31, 2004	2.5%	58	612
Jan. 1, 2005—Mar. 31, 2005	2.5%	10	564
Apr. 1, 2005—Jun. 30, 2005	3.5%	12	566
Jul. 1, 2005—Sep. 30, 2005	3.5%	12	566
Oct. 1, 2005—Dec. 31, 2005	4.5%	14	568
Jan. 1, 2006—Mar. 31, 2006	4.5%	14	568
Apr. 1, 2006—Jun. 30, 2006	4.5%	14	568
Jul. 1, 2006—Sep. 30, 2006	5.5%	16	570
Oct. 1, 2006—Dec. 31, 2006	5.5%	16	570
Jan. 1, 2007—Mar. 31, 2007	5.5%	16	570
Apr. 1, 2007—Jun. 30, 2007	5.5%	16	570
Jul. 1, 2007—Sep. 30, 2007	5.5%	16	570
Oct. 1, 2007—Dec. 31, 2007	5.5%	16	570
Jan. 1, 2008—Mar. 31, 2008	4.5%	62	616
Apr. 1, 2008—Jun. 30, 2008	3.5%	60	614
Jul. 1, 2008—Sep. 30, 2008	2.5%	58	612
Oct. 1, 2008—Dec. 31, 2008	3.5%	60	614
Jan. 1, 2009—Mar. 31, 2009	2.5%	10	564
Apr. 1, 2009—Jun. 30, 2009	1.5%	8	562

TABLE OF INTEREST RATES FOR CORPORATE
OVERPAYMENTS EXCEEDING \$10,000
FROM JANUARY 1, 1995 — PRESENT — Continued

	RATE	1995-1 C.B. TABLE	PG
Jul. 1, 2009—Sep. 30, 2009	1.5%	8	562
Oct. 1, 2009—Dec. 31, 2009	1.5%	8	562
Jan. 1, 2010—Mar. 31, 2010	1.5%	8	562
Apr. 1, 2010—Jun. 30, 2010	1.5%	8	562
Jul. 1, 2010—Sep. 30, 2010	1.5%	8	562
Oct. 1, 2010—Dec. 31, 2010	1.5%	8	562
Jan. 1, 2011—Mar. 31, 2011	0.5%*		
Apr. 1, 2011—Jun. 30, 2011	1.5%	8	562
Jul. 1, 2011—Sep. 30, 2011	1.5%	8	562
Oct. 1, 2011—Dec. 31, 2011	0.5%*		
Jan. 1, 2012—Mar. 31, 2012	0.5%*		
Apr. 1, 2012—Jun. 30, 2012	0.5%*		
Jul. 1, 2012—Sep. 30, 2012	0.5%*		

Part III. Administrative, Procedural, and Miscellaneous

Health Flexible Spending Arrangements not Subject to \$2,500 Limit on Salary Reduction Contributions for Plan Years Beginning before 2013 and Comments Requested on Potential Modification of Use-or-Lose Rule

Notice 2012-40

I. PURPOSE AND OVERVIEW

This notice provides guidance on the effective date of the \$2,500 limit (as indexed for inflation) on salary reduction contributions to health flexible spending arrangements (health FSAs) under § 125(i) of the Internal Revenue Code (Code) (the \$2,500 limit) and on the deadline for amending plans to comply with that limit. This notice also provides relief for certain contributions that mistakenly exceed the \$2,500 limit and that are corrected in a timely manner. Finally, the notice requests comments on whether to modify the use-or-lose rule that is currently set forth in the proposed regulations with respect to health FSAs.

Specifically, this notice provides that —

- the \$2,500 limit does not apply for plan years that begin before 2013;
- the term “taxable year” in § 125(i) refers to the plan year of the cafeteria plan as this is the period for which salary reduction elections are made;
- plans may adopt the required amendments to reflect the \$2,500 limit at any time through the end of calendar year 2014;
- in the case of a plan providing a grace period (which may be up to two months and 15 days), unused salary reduction contributions to the health FSA for plan years beginning in 2012 or later that are carried over into the grace period for that plan year will not count against the \$2,500 limit for the subsequent plan year; and
- relief is provided for certain salary reduction contributions exceeding the \$2,500 limit that are due to a reason-

able mistake and not willful neglect and that are corrected by the employer.

The statutory \$2,500 limit under § 125(i) applies only to salary reduction contributions under a health FSA, and does not apply to certain employer non-elective contributions (sometimes called flex credits), to any types of contributions or amounts available for reimbursement under other types of FSAs, health savings accounts, or health reimbursement arrangements, or to salary reduction contributions to cafeteria plans that are used to pay an employee’s share of health coverage premiums (or the corresponding employee share under a self-insured employer-sponsored health plan).

II. BACKGROUND

A § 125 cafeteria plan is a written plan that allows employees to elect between permitted taxable benefits (such as cash) and certain qualified benefits. Section 125(a), (d)(1). If an employee makes the election before the start of the plan year, and other § 125 requirements are satisfied, the employee’s election of one or more qualified benefits does not result in gross income to the employee.

In 2007, the Treasury Department and the Internal Revenue Service (IRS) published proposed regulations under § 125. 72 Fed. Reg. 43938 (Aug. 6, 2007). Taxpayers may rely on the proposed regulations. The proposed regulations require a written cafeteria plan providing a health FSA to specify the maximum salary reduction contribution as a maximum dollar amount, a maximum percentage of compensation, or other method of determining the maximum salary reduction contribution. See Prop. Treas. Reg. § 1.125-1(c). If a cafeteria plan fails to operate in compliance with § 125 or fails to satisfy any of the written plan requirements for health FSAs, the plan is not a § 125 cafeteria plan and an employee’s election of nontaxable benefits results in gross income to the employee. For additional guidance, see Prop. Treas. Reg. § 1.125-1(c)(1), (c)(6) and (c)(7).

A cafeteria plan may include a grace period of up to two months and 15 days immediately following the end of a plan year.

If the plan provides for a grace period, an employee may use amounts remaining from the previous plan year (including amounts remaining in a health FSA) to pay for expenses incurred for certain qualified benefits during the grace period. See Notice 2005-42, 2005-1 C.B. 1204, and Prop. Treas. Reg. § 1.125-1(e).

Section 125(i) was added by § 9005 of the Patient Protection and Affordable Care Act (the Act), Pub. L. No. 111-148 (as amended by § 10902 of the Act, and further amended by § 1403(b) of the Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152). Section 125(i) is effective for “taxable years” beginning after December 31, 2012. Prior to the effective date of § 125(i), plan sponsors imposed limits on the amount of salary reduction contributions that employees may elect to health FSAs, but there has been no statutory limit.

III. COMPLIANCE WITH THE \$2,500 LIMIT ON SALARY REDUCTION CONTRIBUTIONS TO HEALTH FSAS

Section 125(i) provides that a health FSA is not treated as a qualified benefit unless the cafeteria plan “provides that an employee may not elect for any taxable year to have salary reduction contributions in excess of \$2,500 made to such arrangement.” Because employees make salary reduction contribution elections for health FSAs only on a plan year basis (see Prop. Treas. Reg. § 1.125-2), the term “taxable year” in § 125(i) (which does not specify that it refers, for example, to the employee’s taxable year or to the employer’s taxable year) refers to the plan year of the cafeteria plan. Similarly, the reference to “taxable year” in the effective date provision of § 125(i) refers to the plan year of the cafeteria plan. Accordingly, the \$2,500 limit on health FSA salary reduction contributions applies on a plan year basis and is effective for plan years beginning after December 31, 2012. Also, the \$2,500 limit will be indexed for cost-of-living adjustments for plan years beginning after December 31, 2013. See *General Explanation of Tax Legislation Enacted in the 111th Congress (2011)*, Joint Committee on Taxation, at 317.

A § 125 cafeteria plan may offer only qualified benefits. A plan that offers a nonqualified benefit is not a § 125 cafeteria plan. Section 125(d)(1)(B); see also Prop. Treas. Reg. § 1.125-1(q). Accordingly, a cafeteria plan that fails to comply with § 125(i) for plan years beginning after December 31, 2012 is not a § 125 cafeteria plan and the value of the taxable benefits that an employee could have elected to receive under the plan during the plan year is includible in employee's gross income, regardless of the benefit elected by the employee. See Prop. Treas. Reg. § 1.125-1(b). As explained below, the cafeteria plan must be amended to reflect the \$2,500 limit, and must also comply with the \$2,500 limit in operation.

Consistent with Prop. Treas. Reg. § 1.125-1(d)(2), a plan year is permitted to be changed only for a valid business purpose. If a principal purpose of changing from a calendar year to a fiscal year is to delay the application of the \$2,500 limit, the change is not for a valid business purpose. If a change in the plan year does not satisfy this valid business purpose requirement, the plan year for the cafeteria plan remains the plan year that was in effect prior to the attempted change.

If a cafeteria plan has a short plan year (that is, fewer than 12 months) that begins after 2012, the \$2,500 limit must be prorated based on the number of months in that short plan year.

The \$2,500 limit on salary reduction contributions to a health FSA applies on an employee-by-employee basis. Thus, \$2,500 (as indexed for inflation) is the maximum salary reduction contribution each employee may make for a plan year, regardless of the number of other individuals (for example, a spouse, dependents, or adult children (see § 105(b)) whose medical expenses are reimbursable under the employee's health FSA. Consistent with this rule, if each of two spouses is eligible to elect salary reduction contributions to an FSA, each spouse may elect to make salary reduction contributions of up to \$2,500 (as indexed for inflation) to his or her health FSA, even if both participate in the same health FSA sponsored by the same employer.

All employers that are treated as a single employer under § 414(b), (c), or (m), relating to controlled groups and affiliated service groups, are treated as a single em-

ployer for purposes of the \$2,500 limit. If an employee participates in multiple cafeteria plans offering health FSAs maintained by members of a controlled group or affiliated service group, the employee's total health FSA salary reduction contributions under all of the cafeteria plans are limited to \$2,500 (as indexed for inflation). Section 125(g)(4). However, an employee employed by two or more employers that are not members of the same controlled group may elect up to \$2,500 (as indexed for inflation) under each employer's health FSA.

As noted, the \$2,500 limit applies only to salary reduction contributions and not to employer non-elective contributions, sometimes called flex credits. Generally, an employer may make flex credits available to an employee who is eligible to participate in the cafeteria plan, to be used (at the employee's election) only for one or more qualified benefits. For further information on flex credits, see Prop. Treas. Reg. § 1.125-5(b). For example, if an employer contributes a \$500 flex credit to each employee's health FSA for the 2013 plan year, each employee may still elect to make salary reduction contributions of \$2,500 (as indexed for inflation) to a health FSA for that plan year. However, if an employer provides flex credits that employees may elect to receive as cash or as a taxable benefit, those flex credits are treated as salary reduction contributions for purposes of § 125(i).

The statute imposes the \$2,500 limit only on salary reduction contributions to a health FSA in a cafeteria plan and does not limit the amount permitted for reimbursement under other employer-provided coverage, such as employee salary reduction contributions to an FSA for dependent care assistance or adoption care assistance. The limit also does not apply to salary reduction contributions to a cafeteria plan that are used to pay an employee's share of health coverage premiums (or the corresponding employee share under a self-insured employer-sponsored health plan) — sometimes referred to as “premium conversion” salary reduction contributions — nor does it apply to salary reduction or any other contributions to a health savings account (HSA) or to amounts made available by an employer under a health reimbursement arrangement (HRA).

If a plan provides for a grace period (which, as noted above, can be no longer than two months and 15 days) for a plan year, unused salary reduction contributions to the health FSA for the plan year that are carried over into the grace period do not count against the \$2,500 limit applicable for the subsequent plan year.

If a cafeteria plan timely complies with the written plan requirement limiting health FSA salary reduction contributions as set forth in section IV, below, but one or more employees are erroneously allowed to elect a salary reduction of more than \$2,500 (as indexed for inflation) for a plan year, the cafeteria plan will continue to be a § 125 cafeteria plan for that plan year if (1) the terms of the plan apply uniformly to all participants (consistent with Prop. Treas. Reg. § 1.125-1(c)(1)); (2) the error results from a reasonable mistake by the employer (or the employer's agent) and is not due to willful neglect by the employer (or the employer's agent); and (3) salary reduction contributions in excess of \$2,500 (as indexed for inflation) are paid to the employee and reported as wages for income tax withholding and employment tax purposes on the employee's Form W-2, *Wage and Tax Statement* (or Form W-2c, *Corrected Wage and Tax Statement*) for the employee's taxable year in which, or with which, ends the cafeteria plan year in which the correction is made.

The relief provided in this section III with respect to erroneous excess contributions is not available for an employer if a federal tax return of the employer is under examination with respect to benefits provided under a cafeteria plan with respect to any cafeteria plan year during which the failure to comply with § 125(i) occurred. For this purpose, an employer is treated as under examination if the employer receives written notification (for example, by plan examination, information document request (IDR), or notification of proposed adjustments to a federal tax return) from the examining agent(s) specifically citing § 125(i) as an issue under consideration.

IV. WRITTEN CAFETERIA PLAN AMENDMENT

A cafeteria plan offering a health FSA must be amended to set forth the \$2,500 limit (or, at the employer's option, a

lower limit specified in the plan). Cafeteria plan amendments may be effective only prospectively. See Prop. Treas. Reg. § 1.125-1(c). Notwithstanding this rule against retroactive amendments, an amendment to conform a cafeteria plan to the requirements of § 125(i) that is adopted on or before December 31, 2014, may be made effective retroactively, provided that the cafeteria plan operates in accordance with the requirements of § 125(i) (including the guidance under this notice) for plan years beginning after December 31, 2012. This amendment to the written cafeteria plan may be expressed as a maximum dollar amount or by another method of determining the maximum dollar amount of salary reduction contributions to a health FSA, but in no case may the plan permit a participant to make salary reduction contributions, for a plan year beginning after December 31, 2012, exceeding the \$2,500 limit.

V. EXAMPLES

The rules of this notice are illustrated by the following examples. For all examples, it is assumed that the cafeteria plan otherwise satisfies all of the requirements of § 125 and the proposed regulations, and that the employer is not a member of a controlled group or affiliated service group.

Example 1. (i) Employer W offers a calendar year cafeteria plan including a health FSA. Employer W amends its written cafeteria plan by December 31, 2014, to provide that, effective for the plan year beginning on January 1, 2013, employee salary reduction contributions to a health FSA are limited to \$2,500 (as indexed for inflation).

(ii) Employer W's written cafeteria plan satisfies the requirements of § 125(i).

Example 2. (i) Employer X offers a calendar year cafeteria plan including a health FSA with a grace period of two months and 15 days that complies with Notice 2005-42 and the proposed regulations. Effective for the 2012 plan year, the written plan provides that employee salary reduction contributions for the health FSA are limited to \$5,000. Effective for the 2013 plan year, the written plan provides that employee salary reduction contributions to the health FSA are limited to \$2,500 (as indexed for inflation). Some employees have unused amounts from their 2012 health FSA salary reduction contributions that remain available during the grace period in the first two months and 15 days of 2013.

(ii) The availability during the grace period of amounts attributable to 2012 health FSA salary reduction contributions does not cause Employer X's cafeteria plan to fail to satisfy the \$2,500 limit.

VI. EFFECTIVE DATES

Under the guidance provided in this notice, section 125(i) applies to plan years beginning after December 31, 2012. Indexing of the \$2,500 limit applies to plan years beginning after December 31, 2013.

VII. EFFECT ON OTHER DOCUMENTS

The Treasury Department and the IRS intend to amend the regulations under §§ 1.125-1, 1.125-2, and 1.125-5 to provide for the \$2,500 limit, and taxpayers may rely on the foregoing guidance in this notice pending issuance of the amended regulations.

VIII. REQUEST FOR COMMENTS ON POSSIBLE MODIFICATION OF USE-OR-LOSE RULE FOR HEALTH FSAS

In light of the \$2,500 limit, the Treasury Department and the IRS are considering whether, for health FSAs, the position contained in proposed regulations that is often referred to as the "use-or-lose" rule should be modified. That rule generally prohibits any contribution or benefit under an FSA from being used in a subsequent plan year or period of coverage. See Prop. Treas. Reg. § 1.125-1, Q&A-7(b) (1984); Prop. Treas. Reg. § 1.125-2, Q&A-5 & Q&A-7 (1989); Prop. Treas. Reg. § 1.125-5(c) (2007). Thus, under this rule, unused amounts in the health FSA are "forfeited" at the end of the plan year.

The \$2,500 limit, while not addressing the "use-or-lose" rule, limits the potential for using health FSAs to defer compensation and the extent to which salary reduction amounts may accumulate over time. Given the \$2,500 limit, the Treasury Department and the IRS are considering whether the use-or-lose rule for health FSAs should be modified to provide a different form of administrative relief (instead of, or in addition to, the current 2 1/2 month grace period rule). Comments are requested on whether the proposed regulations should be modified to provide additional flexibility with respect to the operation of the use-or-lose rule for health FSAs and, if so, how any such flexibility might be formulated and constrained. Comments are also requested on how any such mod-

ifications would interact with the \$2,500 limit.

This section VIII of this notice does not constitute guidance and may not be relied upon by taxpayers.

Comments must be submitted by August 17, 2012. Comments should include a reference to Notice 2012-40. Send submissions to CC:PA:LPD:PR (Notice 2012-40), Room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered **Monday through Friday** between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (Notice 2012-40), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC 20044, or sent electronically, via the following e-mail address: Notice.comments@irscounsel.treas.gov.

Please include "Notice 2012-40" in the subject line of any electronic communication. All material submitted will be available for public inspection and copying.

DRAFTING INFORMATION

The principal author of this notice is Elizabeth Purcell of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). For further information regarding this notice, contact Ms. Purcell at (202) 622-6080 (not a toll-free call).

Extension of Relief and Procedures Under Notice 2010-30 and Notice 2011-16 for Spouses of U.S. Servicemembers Who are Working In or Claiming Residence or Domicile In a U.S. Territory Under the Military Spouses Residency Relief Act

Notice 2012-41

On April 15, 2010, the Department of the Treasury (Treasury Department) and the Internal Revenue Service (IRS) published Notice 2010-30, 2010-18 I.R.B. 650, which provides relief and procedures

for certain taxpayers who are spouses (civilian spouses) of active duty members of the uniformed services (servicemembers). The relief and procedures were made available to civilian spouses who (A) accompany their servicemember spouses to a military duty station in American Samoa, Guam, the Northern Mariana Islands (NMI), Puerto Rico, or the U.S. Virgin Islands (USVI) (each a “U.S. territory”) and claim residence or domicile (tax residence) in one of the 50 States or the District of Columbia under the Military Spouses Residency Relief Act (MSRRA) or (B) accompany their servicemember spouses to a military duty station in one of the 50 States or the District of Columbia and claim tax residence in a U.S. territory under MSRRA. The relief and procedures set forth in Notice 2010–30 were initially available for the taxable year including November 11, 2009 (generally, this would be calendar year 2009, referred to hereinafter as 2009). On April 8, 2011, the Treasury Department and the IRS published Notice 2011–16, 2011–17 I.R.B. 720, which extended the relief and procedures announced in Notice 2010–30 to the first taxable year beginning after November 11, 2009 (generally, this would be calendar year 2010).

This notice further extends the relief set forth in Notice 2010–30 for civilian spouses described in the prior paragraph to taxable years beginning after November 11, 2010 (generally, these will be calendar year 2011 and subsequent calendar years, referred to hereinafter as 2011 and subsequent taxable years), and provides that such civilian spouses should follow the applicable procedures described in Notice 2010–30.

The extension of time to pay federal income taxes described in Part III(A)(1)(b) of Notice 2010–30 for 2009 is available to eligible civilian spouses described in Part III(A)(1)(b) of Notice 2010–30 claiming MSRRA relief with respect to individual federal income tax returns filed for 2011 and subsequent taxable years. To obtain an extension of time through October 17, 2012, to pay federal income taxes for 2011, such taxpayers should follow the procedures in Part III(A)(1)(b) of Notice 2010–30. To obtain an extension to pay federal income taxes for subsequent taxable years, such taxpayers should follow those same procedures adjusted for the ap-

propriate filing dates in each such subsequent taxable year.

As provided in Notice 2010–30, the IRS has also determined pursuant to section 6654(e)(3)(A) of the Internal Revenue Code that, with respect to civilian spouses eligible for the extension of time to pay federal income taxes described in this notice and Part III(A)(1)(b) of Notice 2010–30, the addition to tax under section 6654(a) will not apply in the case of an underpayment of estimated tax by such civilian spouses for 2011 and subsequent taxable years due to unusual circumstances.

Civilian spouses who obtain the extension to pay federal income taxes for 2011 and subsequent taxable years provided by this notice are required to pay interest on the amount of tax from the original payment due date until the date the tax is paid. Pursuant to section 6601, interest is calculated from the prescribed payment due date determined under section 6151 without regard to any extension to pay federal income tax, including the extension to pay tax provided by this notice.

For the reasons discussed in Part III(A)(2) of Notice 2010–30, the extension to pay federal income taxes described in Part III(A)(1)(b) of Notice 2010–30 is not available to civilian spouses claiming tax residence in a State or the District of Columbia under MSRRA and filing individual federal income tax returns for 2011 and subsequent taxable years who are (A) federal employees in American Samoa, Guam, or the USVI, or (B) individuals working in Guam or the NMI to whom section 935 applies. These civilian spouses should file their individual federal income tax returns for 2011 and subsequent taxable years, and pay any taxes due, according to the procedures described in Part III(A)(2) of Notice 2010–30.

Civilian spouses who accompany their servicemember spouses to a military duty station in one of the 50 States or the District of Columbia and who claim tax residence in a U.S. territory under MSRRA should follow the procedures in Part III(B) of Notice 2010–30 with respect to their individual federal income tax returns for 2011 and subsequent taxable years.

DRAFTING INFORMATION

The principal author of this notice is Jackie B. Manasterli of the Office of

Associate Chief Counsel (International). For further information regarding this notice, contact Jackie B. Manasterli at (202) 435–5262 (not a toll-free call).

Credit for Carbon Dioxide Sequestration 2012 Section 45Q Inflation Adjustment Factor

Notice 2012–42

SECTION 1. PURPOSE

This notice publishes the inflation adjustment factor for the credit for carbon dioxide (CO₂) sequestration under § 45Q of the Internal Revenue Code (§ 45Q credit) for calendar year 2012. The inflation adjustment factor is used to determine the amount of the credit allowable under § 45Q. The calendar year 2012 inflation-adjusted credit applies to the amount of qualified CO₂ captured by a taxpayer at a qualified facility and disposed of in secure geological storage.

SECTION 2. BACKGROUND

Section 45Q(a)(1) allows a credit of \$20 per metric ton of qualified CO₂ that is captured by the taxpayer at a qualified facility, disposed of by the taxpayer in secure geological storage, and not used by the taxpayer as a tertiary injectant. Section 45Q(a)(2) allows a credit of \$10 per metric ton of qualified CO₂ that is captured by the taxpayer at a qualified facility, used by the taxpayer as a tertiary injectant in a qualified enhanced oil or natural gas recovery project, and disposed of by the taxpayer in secure geological storage.

Section 45Q(b)(1) defines the term “qualified carbon dioxide” as CO₂ captured from an industrial source that would otherwise be released into the atmosphere as industrial emission of greenhouse gas, and that is measured at the source of capture and verified at the point of disposal or injection. Qualified CO₂ includes the initial deposit of captured CO₂ used as a tertiary injectant but does not include CO₂ that is re-captured, recycled, or otherwise re-injected as part of the enhanced oil and natural gas recovery process.

Section 45Q(c) defines the term “qualified facility” as an industrial facility that

is owned by the taxpayer, where carbon capture equipment is placed in service, and where at least 500,000 metric tons of CO₂ is captured during the taxable year.

Section 45Q(d)(2) provides that the Secretary, in consultation with the Administrator of the Environmental Protection Agency (EPA), the Secretary of Energy, and the Secretary of the Interior, shall establish regulations for determining adequate security measures for the geological storage of CO₂ under subsection (a)(1)(B) or (a)(2)(C) such that the CO₂ does not escape into the atmosphere. See section 5 of Notice 2009–83, 2009–44 I.R.B. 588, for procedures regarding secure geological storage.

Section 45Q(d)(5) allows the § 45Q credit to the person that captures and physically or contractually ensures the disposal of or the use as a tertiary injectant of the qualified CO₂, except to the extent provided in regulations prescribed by the Secretary.

Under § 45Q(d)(7), for taxable years beginning in a calendar year after 2009, the dollar amount contained in § 45Q(a) must be adjusted for inflation by multiplying such dollar amount by the inflation adjustment factor for such calendar year determined under § 43(b)(3)(B), determined by substituting “2008” for “1990.”

Section 43(b)(3)(B) defines “inflation adjustment factor” as, with respect to any calendar year, a fraction the numerator of which is the GNP implicit price deflator for the preceding calendar year and the denominator of which is the GNP implicit price deflator for 1990. For purposes of § 45Q(d)(7), with respect to 2012 calendar year, the inflation adjustment factor is a fraction the numerator of which is the GNP implicit price deflator for 2011 (113.347) and the denominator of which is the GNP implicit price deflator for 2008 (108.589).

Section 45Q(e) provides that the § 45Q credit will apply with respect to qualified CO₂ before the end of the calendar year in which the Secretary, in consultation with

the EPA, certifies that 75,000,000 metric tons of qualified CO₂ have been taken into account in accordance with § 45Q(a).

SECTION 3. INFLATION ADJUSTMENT FACTOR

The inflation adjustment factor for calendar year 2012 is 1.0438. The 45Q credit for calendar year 2012 is \$20.88 per metric ton of qualified CO₂ under § 45Q(a)(1) and \$10.44 per metric ton of qualified CO₂ under § 45Q(a)(2).

SECTION 4. DRAFTING INFORMATION

The principal author of this notice is Jennifer C. Bernardini of the Office of Associate Chief Counsel (Passthroughs & Special Industries). For further information regarding this notice, contact Ms. Bernardini at (202) 622–3110 (not a toll-free call).

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

Notice 2012–43

This notice provides guidance as to the corporate bond weighted average interest rate and the permissible range of interest rates specified under § 412(b)(5)(B)(ii)(II) of the Internal Revenue Code as in effect for plan years beginning before 2008. It also provides guidance on the corporate bond monthly yield curve (and the corresponding spot segment rates), and the 24-month average segment rates under § 430(h)(2). In addition, this notice provides guidance as to the interest rate on 30-year Treasury securities under § 417(e)(3)(A)(ii)(II) as in effect for plan years beginning before 2008, the 30-year Treasury weighted average rate under § 431(c)(6)(E)(ii)(I), and the minimum present value segment rates under

§ 417(e)(3)(D) as in effect for plan years beginning after 2007.

CORPORATE BOND WEIGHTED AVERAGE INTEREST RATE

Sections 412(b)(5)(B)(ii) and 412(l)(7)(C)(i), as amended by the Pension Funding Equity Act of 2004 and by the Pension Protection Act of 2006 (PPA), provide that the interest rates used to calculate current liability and to determine the required contribution under § 412(l) for plan years beginning in 2004 through 2007 must be within a permissible range based on the weighted average of the rates of interest on amounts invested conservatively in long term investment grade corporate bonds during the 4-year period ending on the last day before the beginning of the plan year.

Notice 2004–34, 2004–1 C.B. 848, provides guidelines for determining the corporate bond weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability. That notice establishes that the corporate bond weighted average is based on the monthly composite corporate bond rate derived from designated corporate bond indices. The methodology for determining the monthly composite corporate bond rate as set forth in Notice 2004–34 continues to apply in determining that rate. See Notice 2006–75, 2006–2 C.B. 366.

The composite corporate bond rate for May 2012 is 4.39 percent. Pursuant to Notice 2004–34, the Service has determined this rate as the average of the monthly yields for the included corporate bond indices for that month.

The following corporate bond weighted average interest rate was determined for plan years beginning in the month shown below.

For Plan Years Beginning in		Corporate Bond Weighted Average	Permissible Range	
Month	Year		90%	100%
June	2012	5.44	4.90	5.44

YIELD CURVE AND SEGMENT RATES

Generally for plan years beginning after 2007 (except for delayed effective dates for certain plans under sections 104, 105, and 106 of PPA), § 430 of the Code specifies the minimum funding requirements that apply to single employer plans pursuant to § 412. Section 430(h)(2) specifies the interest rates that must be used to determine a plan’s target normal cost and funding target. Under this provision, present value is generally determined using three 24-month average interest rates

(“segment rates”), each of which applies to cash flows during specified periods. However, an election may be made under § 430(h)(2)(D)(ii) to use the monthly yield curve in place of the segment rates. Section 430(h)(2)(G) set forth a transitional rule applicable to plan years beginning in 2008 and 2009 under which the segment rates were blended with the corporate bond weighted average described above, including an election under § 430(h)(2)(G)(iv) for an employer to use the segment rates without the transitional rule.

Notice 2007–81, 2007–2 C.B. 899, provides guidelines for determining the

monthly corporate bond yield curve, and the 24-month average corporate bond segment rates used to compute the target normal cost and the funding target. Pursuant to Notice 2007–81, the monthly corporate bond yield curve derived from May 2012 data is in Table I at the end of this notice. The spot first, second, and third segment rates for the month of May 2012 are, respectively, 1.59, 4.12, and 5.04. The three 24-month average corporate bond segment rates applicable for June 2012 are as follows:

First Segment	Second Segment	Third Segment
1.84	4.79	5.90

The transitional rule of § 430(h)(2)(G) does not apply to plan years beginning after December 31, 2009. Therefore, for a plan year beginning after 2009 with a look-back month to June 2012, the funding segment rates are the three 24-month average corporate bond segment rates applicable for June 2012, listed above without blending for any transitional period.

30-YEAR TREASURY SECURITIES INTEREST RATES

Section 417(e)(3)(A)(ii)(II) (prior to amendment by PPA) defines the applicable interest rate, which must be used for purposes of determining the minimum present value of a participant’s benefit under § 417(e)(1) and (2), as the annual rate of interest on 30-year Treasury securities for the month before the date of distribution or such other time as the

Secretary may by regulations prescribe. Section 1.417(e)–1(d)(3) of the Income Tax Regulations provides that the applicable interest rate for a month is the annual rate of interest on 30-year Treasury securities as specified by the Commissioner for that month in revenue rulings, notices or other guidance published in the Internal Revenue Bulletin.

The rate of interest on 30-year Treasury securities for May 2012 is 2.93 percent. The Service has determined this rate as the average of the yield on the 30-year Treasury bond maturing in February 2042 determined each day through May 9, 2012, and the yield on the 30-year Treasury bond maturing in May 2042 determined each day for the balance of the month.

Generally for plan years beginning after 2007, § 431 specifies the minimum funding requirements that apply to

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

For Plan Years Beginning in		30-Year Treasury Weighted Average	Permissible Range	
Month	Year		90%	to 105%
June	2012	3.88	3.49	4.08

MINIMUM PRESENT VALUE SEGMENT RATES

Generally for plan years beginning after December 31, 2007, the applicable interest rates under § 417(e)(3)(D) are segment rates computed without regard to a

24-month average. For plan years beginning in 2008 through 2011, the applicable interest rates are the monthly spot segment rates blended with the applicable rate under § 417(e)(3)(A)(ii)(II) as in effect for plan years beginning in 2007. Notice 2007–81 provides guidelines for determin-

ing the minimum present value segment rates. Pursuant to that notice, the minimum present value transitional segment rates determined for May 2012, taking into account the May 2012 30-year Treasury rate of 2.93 stated above, are as follows:

<u>For Plan Years Beginning in</u>	<u>First Segment</u>	<u>Second Segment</u>	<u>Third Segment</u>
2011	1.86	3.88	4.62
2012	1.59	4.12	5.04

DRAFTING INFORMATION

The principal author of this notice is Tony Montanaro of the Employee Plans,

Tax Exempt and Government Entities Division. Mr. Montanaro may be e-mailed at *RetirementPlanQuestions@irs.gov*.

Table I
 Monthly Yield Curve for May 2012
 Derived from May 2012 Data

<i>Maturity</i>	<i>Yield</i>	<i>Maturity</i>	<i>Yield</i>	<i>Maturity</i>	<i>Yield</i>	<i>Maturity</i>	<i>Yield</i>	<i>Maturity</i>	<i>Yield</i>
0.5	0.52	20.5	4.83	40.5	5.07	60.5	5.16	80.5	5.20
1.0	0.85	21.0	4.84	41.0	5.07	61.0	5.16	81.0	5.20
1.5	1.14	21.5	4.85	41.5	5.08	61.5	5.16	81.5	5.21
2.0	1.40	22.0	4.86	42.0	5.08	62.0	5.16	82.0	5.21
2.5	1.60	22.5	4.87	42.5	5.08	62.5	5.16	82.5	5.21
3.0	1.78	23.0	4.88	43.0	5.08	63.0	5.17	83.0	5.21
3.5	1.93	23.5	4.88	43.5	5.09	63.5	5.17	83.5	5.21
4.0	2.08	24.0	4.89	44.0	5.09	64.0	5.17	84.0	5.21
4.5	2.24	24.5	4.90	44.5	5.09	64.5	5.17	84.5	5.21
5.0	2.40	25.0	4.91	45.0	5.10	65.0	5.17	85.0	5.21
5.5	2.56	25.5	4.91	45.5	5.10	65.5	5.17	85.5	5.21
6.0	2.72	26.0	4.92	46.0	5.10	66.0	5.17	86.0	5.21
6.5	2.89	26.5	4.93	46.5	5.10	66.5	5.18	86.5	5.21
7.0	3.05	27.0	4.93	47.0	5.11	67.0	5.18	87.0	5.21
7.5	3.21	27.5	4.94	47.5	5.11	67.5	5.18	87.5	5.21
8.0	3.36	28.0	4.95	48.0	5.11	68.0	5.18	88.0	5.22
8.5	3.51	28.5	4.96	48.5	5.11	68.5	5.18	88.5	5.22
9.0	3.65	29.0	4.96	49.0	5.12	69.0	5.18	89.0	5.22
9.5	3.78	29.5	4.97	49.5	5.12	69.5	5.18	89.5	5.22
10.0	3.90	30.0	4.97	50.0	5.12	70.0	5.18	90.0	5.22
10.5	4.01	30.5	4.98	50.5	5.12	70.5	5.18	90.5	5.22
11.0	4.11	31.0	4.99	51.0	5.12	71.0	5.19	91.0	5.22
11.5	4.20	31.5	4.99	51.5	5.13	71.5	5.19	91.5	5.22
12.0	4.28	32.0	5.00	52.0	5.13	72.0	5.19	92.0	5.22
12.5	4.35	32.5	5.00	52.5	5.13	72.5	5.19	92.5	5.22
13.0	4.42	33.0	5.01	53.0	5.13	73.0	5.19	93.0	5.22
13.5	4.47	33.5	5.01	53.5	5.13	73.5	5.19	93.5	5.22
14.0	4.52	34.0	5.02	54.0	5.14	74.0	5.19	94.0	5.22
14.5	4.57	34.5	5.02	54.5	5.14	74.5	5.19	94.5	5.22
15.0	4.61	35.0	5.03	55.0	5.14	75.0	5.19	95.0	5.22
15.5	4.64	35.5	5.03	55.5	5.14	75.5	5.19	95.5	5.23
16.0	4.67	36.0	5.04	56.0	5.14	76.0	5.20	96.0	5.23
16.5	4.70	36.5	5.04	56.5	5.15	76.5	5.20	96.5	5.23
17.0	4.72	37.0	5.04	57.0	5.15	77.0	5.20	97.0	5.23
17.5	4.74	37.5	5.05	57.5	5.15	77.5	5.20	97.5	5.23
18.0	4.76	38.0	5.05	58.0	5.15	78.0	5.20	98.0	5.23
18.5	4.78	38.5	5.05	58.5	5.15	78.5	5.20	98.5	5.23
19.0	4.79	39.0	5.06	59.0	5.15	79.0	5.20	99.0	5.23
19.5	4.81	39.5	5.06	59.5	5.16	79.5	5.20	99.5	5.23
20.0	4.82	40.0	5.07	60.0	5.16	80.0	5.20	100.0	5.23

Part IV. Items of General Interest

Interim Guidance on Rev. Rul. 2012-18

Announcement 2012-25

The Internal Revenue Service (Service) is providing administrative guidelines to examiners concerning Rev. Rul. 2012-18, published in the 2012-26 Internal Revenue Bulletin.¹ The Service is aware that some businesses may have to change automated or manual reporting systems in order to comply with the proper treatment of service charges as specified in Q&A 1 of Rev. Rul. 2012-18.

When performing a tip examination, examiners must ensure that distributed service charges are properly characterized as wages and not tips. Q&A 1 of Rev. Rul. 2012-18 reaffirms the factors that are used to determine whether payments constitute tips or service charges. Q&A 1 of Rev. Rul. 2012-18 provides that the absence of any of the following factors creates a doubt as to whether a payment is a tip and indicates that the payment may be a service charge:

- (1) The payment must be made free from compulsion;
- (2) The customer must have the unrestricted right to determine the amount;

- (3) The payment should not be the subject of negotiation or dictated by employer policy; and,
- (4) Generally, the customer has the right to determine who receives the payment.

The Service is providing the interim guidance memorandum below to its examiners. The memorandum provides that, in limited circumstances, an examiner should apply Q&A 1 of Rev. Rul. 2012-18 prospectively to amounts paid on or after January 1, 2013, in order to allow businesses not currently in compliance additional time to amend their business practices and make needed system changes. The Service is seeking public comments regarding this interim guidance and whether additional time is needed to ensure that systems are compliant. Comments on the interim guidance may be submitted on or before September 24, 2012, either electronically at *TIP.Program@irs.gov* or in writing to:

Internal Revenue Service
National Tip Reporting Compliance
3251 North Evergreen Dr. NE
Grand Rapids, MI 49525

In a future announcement, the Service will also solicit public comments on proposed changes to the Service's exist-

ing voluntary tip compliance agreements. Specifically, the Service is considering significant changes to the Tip Reporting Alternative Commitment (TRAC) program and other variations of TRAC agreements. Versions of the existing voluntary tip compliance agreements are available on the IRS website at Market Segment Understandings (MSU) <http://www.irs.gov/businesses/small/article/0,,id=98944,00.html>. They may also be obtained from the IRS office listed above. The Service is interested in updating its suite of voluntary tip compliance agreements to place a greater emphasis on computations derived from Point of Sale systems and the use of electronic payment settlement methods, such as credit and debit cards. While employee education will remain a focus of the Service's efforts, these new voluntary tip compliance agreements will increase the participants' reliance on internal control systems to improve employee tip reporting compliance.

Following is a copy of the interim guidance memorandum that examiners will use until procedures are published in the Internal Revenue Manual, after receiving and considering comments submitted in response to this announcement.

¹ Among the topics covered in this revenue ruling are reporting and depositing of FICA taxes on tips, Section 3121(q) Notice and Demand issues, and the section 45B credit.



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
Washington, D.C. 20224

June 7, 2012

Control No: SBSE-04-0612-057
Expires: June 7, 2013
Impacted IRM: 4.23.7

MEMORANDUM FOR ALL FIELD EXAMINATION OPERATIONS

FROM: Shenita Hicks /s/ Shenita Hicks
Director, Examination, SB/SE

John H. Imhoff Jr. /s/ John H. Imhoff Jr.
Director, Specialty Programs, SB/SE

David Horton /s/ David Horton
Director, Field Specialists, LB&I

Clifford J. Gannett /s/ Clifford J. Gannett
Acting Director, Government Entities, TE/GE

SUBJECT: Interim Guidance on Tips vs. Service Charges
Revenue Ruling 2012-18

The purpose of this memorandum is to provide administrative guidelines to examiners auditing a business where tipping is customary and/or where a business adds service charges to customers' bills which are then distributed to employees. This document is not intended to be a technical position, but to provide audit issue direction to examiners in dealing with these issues.

An employer's characterization of a payment as a "tip" is not determinative. When performing a tip examination, examiners must ensure that distributed service charges are properly characterized as wages and not tips.¹ Recently issued Rev. Rul. 2012-18, published in the 2012-26 Internal Revenue Bulletin, sets forth updated guidance on

¹ Distributed service charges that have been characterized as tips should generally be recharacterized and an adjustment made to the Form 941 under examination via employment tax report Form(s) 4666 and 4668. Service charges are not eligible for the credit claimed on Form 8846, and are not eligible for the General Business Credit claimed on Form 3800. When calculating the amount of unreported tips for an employer-only assessment under section 3121(q) of the Internal Revenue Code, examiners must ensure they do not include service charges in the Section 3121(q) Notice and Demand.

FICA taxes on tips.² Specifically, Q&A 1 of Rev. Rul. 2012-18 reaffirms the factors which are used to determine whether payments constitute tips or service charges found in Rev. Rul. 59-252, 1952 C.B. 215. Q&A 1 of Rev. Rul. 2012-18 provides that the absence of any of the following factors creates a doubt as to whether a payment is a tip and indicates that the payment may be a service charge:

- (1) The payment must be made free from compulsion;
- (2) The customer must have the unrestricted right to determine the amount;
- (3) The payment should not be the subject of negotiation or dictated by employer policy; and,
- (4) Generally, the customer has the right to determine who receives the payment.

Rev. Rul. 2012-18 also provides specific examples of amounts characterized as tips and service charges to illustrate the application of these factors.³ Example A in Q&A 1 of Rev. Rul. 2012-18 illustrates a service charge paid by a large party when the menu specifies that a fixed charge will be added to all bills for parties of 6 or more customers and Example B illustrates a tip when the charge receipt shows sample tip calculations.

Rev. Rul. 2012-18 is effective immediately and applicable retroactively. However, under very limited facts and circumstances (specified below) with regard to amounts paid before January 1, 2013, that were improperly characterized as tips when they properly should have been characterized as service charges, an examiner should apply Q&A 1 of this revenue ruling prospectively, *i.e.*, only to amounts paid on or after January 1, 2013. To the extent that Q&A 1 of this revenue ruling is applied without retroactive effect, an employer will not be required to pay any additional taxes. Employers that correctly treated service charges as wages are not entitled to a refund of any taxes they may have paid or will pay due to their proper reporting of service charges as wages.

In determining whether Q&A 1 of this revenue ruling should be applied prospectively, examiners should consider whether the set of facts and circumstances at issue was directly addressed in prior guidance and whether the business needs additional time to amend its business practices and make system changes to come into compliance. Some of the prior guidance which may be applicable includes Rev. Rul. 57-397, 1957-2 C.B. 628 (where amounts required to be paid to a hotel by customers for using dining facilities included amounts distributed by the hotel to waiters and other employees); Rev. Rul. 59-252 (where negotiations between a hotel and customer for use of hotel's banquet facilities included additional amounts for distribution to employees); Rev. Rul. 64-40, 1964-1 C.B. 68 (where a club's board of governors determined amounts

² Among the topics covered in this revenue ruling are reporting and depositing of FICA taxes on tips, Section 3121(q) Notice and Demand issues, and the section 45B credit.

³ Other examples of amounts which should generally be characterized as service charges when any of the factors outlined in Q&A 1 of Rev. Rul. 2012-18 are absent include amounts paid by a customer for catering, banquets, weddings, transportation, and baggage handling and other amounts (frequently referred to by the service industry as "auto-gratuities") that are dictated by the policy of the employer.

distributed to employees from a fund made up of contributions by club members); Rev. Rul. 66-74, 1966-1 C.B. 229 (where amounts collected by a club through mandatory charges added to members' bills were distributed to employees); and Rev. Rul. 69-28, 1969-1 C.B. 270 (where five examples of amounts paid to employees are discussed). If examiners find that the set of facts and circumstances at issue was not directly addressed in prior guidance, then Q&A 1 of Rev. Rul. 2012-18 should be applied prospectively. In this regard, Q&A 1 should be applied prospectively to amounts paid under facts that are substantially the same as Example A.

When performing a tip rate review, examiners must ensure that distributed service charges are properly characterized as wages and not tips. Service charges should not be included in any calculation that arrives at an hourly tip rate, a tip rate calculated on a percentage of sales, or any other rate determination method. Examiners should note in their work papers and appendices that service charges were not included in the tip rate computations and how the employer should account for service charges.

In the past, due to automated or manual taxpayer business systems which failed to accurately classify payments, IRS examiners may have treated service charges as tip income for purposes of computing unreported tips or tip rates for voluntary tip compliance agreements. Note that existing agreements are not voided as a result of this memorandum. Examiners may contact establishments possessing an agreement to conduct a tip rate review to consider the tips vs. service charges issue. This will not constitute a "tip examination" within the meaning of an agreement. If distributed service charges were treated as tips, the agreement will be modified.

An examiner who encounters business practices which are unfamiliar or makes an initial determination that Rev. Rul. 2012-18 does not apply retroactively to a particular set of facts and circumstances should discuss the issue with Idolina Volz, SBSE National Tip Reporting Compliance Program, Senior Policy Analyst. Any questions by examiners regarding this memo should also be addressed to Ms. Volz.

cc: www.irs.gov

Definition of Terms

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

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

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

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

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A

and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

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

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

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance

of a prior ruling, a combination of terms is used. For example, *modified* and *superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case, the previously published ruling is first modified and then, as modified, is superseded.

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

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

Abbreviations

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

A—Individual.
Acq.—Acquiescence.
B—Individual.
BE—Beneficiary.
BK—Bank.
B.T.A.—Board of Tax Appeals.
C—Individual.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
CI—City.
COOP—Cooperative.
Ct.D.—Court Decision.
CY—County.
D—Decedent.
DC—Dummy Corporation.
DE—Donee.
Del. Order—Delegation Order.
DISC—Domestic International Sales Corporation.
DR—Donor.
E—Estate.
EE—Employee.
E.O.—Executive Order.

ER—Employer.
ERISA—Employee Retirement Income Security Act.
EX—Executor.
F—Fiduciary.
FC—Foreign Country.
FICA—Federal Insurance Contributions Act.
FISC—Foreign International Sales Company.
FPH—Foreign Personal Holding Company.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
FX—Foreign corporation.
G.C.M.—Chief Counsel’s Memorandum.
GE—Grantee.
GP—General Partner.
GR—Grantor.
IC—Insurance Company.
I.R.B.—Internal Revenue Bulletin.
LE—Lessee.
LP—Limited Partner.
LR—Lessor.
M—Minor.
Nonacq.—Nonacquiescence.
O—Organization.
P—Parent Corporation.
PHC—Personal Holding Company.
PO—Possession of the U.S.
PR—Partner.

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

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Ann	Announcement
CD	Court Decision
DO	Delegation Order
EO	Executive Order
PL	Public Law
PTE	Prohibited Transaction Exemption
RP	Revenue Procedure
RR	Revenue Ruling
SPR	Statement of Procedural Rules
TC	Tax Convention
TD	Treasury Decision
TDO	Treasury Department Order

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