Internal Revenue
bulletin

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HIGHLIGHTS OF THIS ISSUE

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

INCOME TAX

REG–106796–12, page 1164.

These proposed regulations provide guidance on the application of section 162(m)(6). Section 162(m)(6) limits the allowable deduction for remuneration for services provided by individuals to certain health insurance providers. Section 162(m)(6) was enacted as part of the Patient Protection and Affordable Care Act (Public Law 111–148, 124 Stat. 119, 868 (2010)).

Notice 2013–33, page 1140.

Credit for Renewable Electricity Production, Refined Coal Production, and Indian Coal Production, and Publication of Inflation Adjustment Factors and Reference Prices for Calendar Year 2013: This notice reports for 2013 the inflation adjustment factors and reference prices used to determine the availability of the section 45 credit for electricity produced from qualified energy resources and refined coal, and includes the credit amounts for renewable electricity production and refined coal production. This notice also reports the inflation adjustment factor for Indian coal and includes the credit amounts for Indian coal production.

Rev. Proc. 2013–24, page 1142.

This revenue procedure provides definitions of units of property and major components for steam or electric power generation property primarily used in the trade or business of generating or selling steam or electricity. The property definitions provided in this revenue procedure may be used to determine whether expenditures to maintain, replace, or improve steam or electric power generation property must be capitalized under § 263(a) of the Code. This revenue procedure also provides procedures for obtaining automatic consent to change to a method of accounting that uses all, or some of, the unit of property definitions provided and also provides an extrapolation methodology an eligible taxpayer may use in connection with a change in method of accounting for determining the amount of a § 481(a) adjustment.

Rev. Proc. 2013–26, page 1160.

This revenue procedure provides rules by which the Internal Revenue Service will allow a taxpayer to use the proportional method of accounting for original issue discount ("OID") on pools of credit card receivables under section 1272(a)(6). The proportional method allocates to an accrual period an amount of unaccrued OID that is proportional to the amount of pool principal that is paid by cardholders during the period. This revenue procedure also describes the exclusive procedures by which a taxpayer may obtain the Commissioner's consent to change to the proportional method. Rev. Proc. 2011–14 is modified.

Announcement 2013–32, page 1192.

The IRS has revoked its determination that Grangeville Country Club, Inc. of Grangeville, ID., and Michael Joy Fine Arts Scholarship Fund of Victoria, TX., qualify as organizations described in sections 501(c)(3) and 170(c)(2) of the Code.

EMPLOYEE PLANS

REG–106796–12, page 1164.

These proposed regulations provide guidance on the application of section 162(m)(6). Section 162(m)(6) limits the allowable deduction for remuneration for services provided by individuals to certain health insurance providers. Section 162(m)(6) was enacted as part of the Patient Protection and Affordable Care Act (Public Law 111–148, 124 Stat. 119, 868 (2010)).

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Finding Lists begin on page ii.
Index for January through May begins on page v.

Department of the Treasury
Internal Revenue Service

Notice 2013–32, page 1137.
This notice contains updates for the corporate bond weighted average interest rate for plan years beginning in May 2013; the 24-month average segment rates; the funding transitional segment rates applicable for May 2013; and the minimum present value transitional rates for April 2013. The rates in this notice reflect certain changes implemented by the Moving Ahead for Progress in the 21st Century Act, Public Law 112–141 (MAP-21).

EXEMPT ORGANIZATIONS

Announcement 2013–32, page 1192.
The IRS has revoked its determination that Grangeville Country Club, Inc. of Grangeville, ID., and Michael Joy Fine Arts Scholarship Fund of Victoria, TX., qualify as organizations described in sections 501(c)(3) and 170(c)(2) of the Code.

The IRS Mission

Provide America's taxpayers top-quality service by helping them understand and meet their tax responsibilities and enforce the law with integrity and fairness to all.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly.

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

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

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

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

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

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

Part IV.—Items of General Interest.
This part includes notices of proposed rulemakings, disbarment and suspension lists, and announcements.

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

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

Section 162.—Trade or Business Expenses

For purposes of determining whether the cost of replacement property may be deducted under § 162 of the Code, what units of property and major component definitions may be used by a taxpayer that has a depreciable interest in steam or electric power generation property primarily used in the trade or business of generating or selling steam or electricity. See Rev. Proc. 2013-24, page 1142.

Section 446.—General Rule for Methods of Accounting

What are the procedural requirements for obtaining automatic consent to change to a method of accounting that uses all, or some of, the safe-harbor unit of property definitions provided in Rev. Proc. 2013–24 for steam or electric power generation property primarily used in the trade or business of generating or selling steam or electricity. See Rev. Proc. 2013-24, page 1142.

Part III. Administrative, Procedural, and Miscellaneous

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

Notice 2013–32

This notice 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) of the Internal Revenue Code. 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. These rates reflect certain changes implemented by the Moving Ahead for Progress in the 21st Century Act, Public Law 112–141 (MAP–21). MAP–21 provides that for purposes of § 430(h)(2), the segment rates are limited by the applicable maximum percentage or the applicable minimum percentage based on the average of segment rates over a 25-year period.

YIELD CURVE AND SEGMENT RATES

Generally, except for certain plans under sections 104 and 105 of the Pension Protection Act of 2006, § 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. To the extent provided under § 430(h)(2)(C)(iv), these segment rates are adjusted by the applicable percentage of the 25-year average segment rates for the period ending September 30 of the year preceding the calendar year in which the plan year begins. However, an election may be made under § 430(h)(2)(D)(ii) to use the monthly yield curve in place of the segment rates.

Notice 2007–81, 2007–44 I.R.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 April 2013 data is in Table I at the end of this notice. The spot first, second, and third segment rates for the month of April 2013 are, respectively, 0.93, 3.61, and 4.88. For plan years beginning on or after January 1, 2012, the 24-month average segment rates determined under § 430(h)(2)(C)(iv) must be adjusted by the applicable percentage of the corresponding 25-year average segment rates. The 25-year average segment rates for plan years beginning in 2012 and for plan years beginning in 2013 were published in Notices 2012–55 and 2013–11, respectively. The three 24-month average corporate bond segment rates applicable for May 2013 without adjustment, and the adjusted 24-month average segment rates taking into account the applicable percentages of the corresponding 25-year average segment rates, are as follows:

For Plan Years Beginning In			24-Month Average Segment Rates Not Adjusted			Adjusted 24-Month Average Segment Rates, Based on Applicable Percentage of 25-Year Average Rates		
	Applicable Month		First Segment	Second Segment	Third Segment	First Segment	Second Segment	Third Segment
2012	May	2013	1.46	4.15	5.20	5.54	6.85	7.52
2013	May	2013	1.46	4.15	5.20	4.94	6.15	6.76

30-YEAR TREASURY SECURITIES INTEREST RATES

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 rate of interest on 30-year Treasury securities for April 2013 is 2.93 percent. The Service has determined this rate as the average of the daily determinations of yield on the 30-year Treasury bond maturing in February 2043. 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%
May	2013	3.48	3.13		3.66

MINIMUM PRESENT VALUE SEGMENT RATES

In general, the applicable interest rates under § 417(e)(3)(D) are segment rates computed without regard to a 24-month average. Notice 2007–81 provides guidelines for determining the minimum present value segment rates. Pursuant to that notice, the minimum present value segment rates determined for April 2013 are as follows:

First Segment	Second Segment	Third Segment
0.93	3.61	4.88

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 April 2013
Derived from April 2013 Data

Maturity	*Yield*	*Maturity*	*Yield*	*Maturity*	*Yield*	*Maturity*	*Yield*	*Maturity*	*Yield*
0.5	0.27	20.5	4.55	40.5	4.93	60.5	5.06	80.5	5.13
1.0	0.46	21.0	4.57	41.0	4.93	61.0	5.06	81.0	5.13
1.5	0.62	21.5	4.58	41.5	4.93	61.5	5.07	81.5	5.13
2.0	0.77	22.0	4.60	42.0	4.94	62.0	5.07	82.0	5.13
2.5	0.89	22.5	4.61	42.5	4.94	62.5	5.07	82.5	5.13
3.0	1.00	23.0	4.63	43.0	4.95	63.0	5.07	83.0	5.14
3.5	1.12	23.5	4.64	43.5	4.95	63.5	5.07	83.5	5.14
4.0	1.24	24.0	4.65	44.0	4.96	64.0	5.08	84.0	5.14
4.5	1.38	24.5	4.66	44.5	4.96	64.5	5.08	84.5	5.14
5.0	1.54	25.0	4.68	45.0	4.97	65.0	5.08	85.0	5.14
5.5	1.71	25.5	4.69	45.5	4.97	65.5	5.08	85.5	5.14
6.0	1.89	26.0	4.70	46.0	4.97	66.0	5.08	86.0	5.14
6.5	2.08	26.5	4.71	46.5	4.98	66.5	5.09	86.5	5.14
7.0	2.27	27.0	4.72	47.0	4.98	67.0	5.09	87.0	5.14
7.5	2.46	27.5	4.73	47.5	4.99	67.5	5.09	87.5	5.15
8.0	2.64	28.0	4.74	48.0	4.99	68.0	5.09	88.0	5.15
8.5	2.82	28.5	4.75	48.5	4.99	68.5	5.09	88.5	5.15
9.0	2.99	29.0	4.76	49.0	5.00	69.0	5.09	89.0	5.15
9.5	3.15	29.5	4.77	49.5	5.00	69.5	5.10	89.5	5.15
10.0	3.30	30.0	4.78	50.0	5.00	70.0	5.10	90.0	5.15
10.5	3.44	30.5	4.79	50.5	5.01	70.5	5.10	90.5	5.15
11.0	3.57	31.0	4.80	51.0	5.01	71.0	5.10	91.0	5.15
11.5	3.68	31.5	4.81	51.5	5.01	71.5	5.10	91.5	5.15
12.0	3.79	32.0	4.82	52.0	5.02	72.0	5.10	92.0	5.16
12.5	3.88	32.5	4.82	52.5	5.02	72.5	5.11	92.5	5.16
13.0	3.97	33.0	4.83	53.0	5.02	73.0	5.11	93.0	5.16
13.5	4.05	33.5	4.84	53.5	5.02	73.5	5.11	93.5	5.16
14.0	4.11	34.0	4.85	54.0	5.03	74.0	5.11	94.0	5.16
14.5	4.17	34.5	4.85	54.5	5.03	74.5	5.11	94.5	5.16
15.0	4.23	35.0	4.86	55.0	5.03	75.0	5.11	95.0	5.16
15.5	4.27	35.5	4.87	55.5	5.04	75.5	5.12	95.5	5.16
16.0	4.32	36.0	4.87	56.0	5.04	76.0	5.12	96.0	5.16
16.5	4.35	36.5	4.88	56.5	5.04	76.5	5.12	96.5	5.16
17.0	4.39	37.0	4.89	57.0	5.04	77.0	5.12	97.0	5.16
17.5	4.42	37.5	4.89	57.5	5.05	77.5	5.12	97.5	5.17
18.0	4.45	38.0	4.90	58.0	5.05	78.0	5.12	98.0	5.17
18.5	4.47	38.5	4.90	58.5	5.05	78.5	5.12	98.5	5.17
19.0	4.49	39.0	4.91	59.0	5.05	79.0	5.13	99.0	5.17
19.5	4.51	39.5	4.91	59.5	5.06	79.5	5.13	99.5	5.17
20.0	4.53	40.0	4.92	60.0	5.06	80.0	5.13	100.0	5.17

Credit for Renewable Electricity Production, Refined Coal Production, and Indian Coal Production, and Publication of Inflation Adjustment Factors and Reference Prices for Calendar Year 2013

Notice 2013–33

This notice publishes the inflation adjustment factors and reference prices for calendar year 2013 for the renewable electricity production credit, the refined coal production credit, and the Indian coal production credit under section 45 of the Internal Revenue Code. The 2013 inflation adjustment factors and reference prices are used in determining the availability of the credits. The 2013 inflation adjustment factors and reference prices apply to calendar year 2013 sales of kilowatt hours of electricity produced in the United States or a possession thereof from qualified energy resources and to calendar year 2013 sales of refined coal and Indian coal produced in the United States or a possession thereof.

BACKGROUND

Section 45(a) provides that the renewable electricity production credit for any tax year is an amount equal to the product of 1.5 cents multiplied by the kilowatt hours of specified electricity produced by the taxpayer and sold to an unrelated person during the tax year. This electricity must be produced from qualified energy resources and at a qualified facility during the 10-year period beginning on the date the facility was originally placed in service.

Section 45(b)(1) provides that the amount of the credit determined under section 45(a) is reduced by an amount which bears the same ratio to the amount of the credit as (A) the amount by which the reference price for the calendar year in which the sale occurs exceeds 8 cents, bears to (B) 3 cents. Under section 45(b)(2), the 1.5 cent amount in section 45(a), the 8 cent amount in section 45(b)(1), the $4.375 amount in section 45(e)(8)(A), the $2.00 amount in section 45(e)(8)(D)(ii)(I), and in section 45(e)(8)(B)(i), the reference price of fuel used as feedstock (within the meaning of section 45(c)(7)(A)) in 2002 are each adjusted by multiplying the amount by the inflation adjustment factor for the calendar year in which the sale occurs. If any amount as increased under the preceding sentence is not a multiple of 0.1 cent, the amount is rounded to the nearest multiple of 0.1 cent. In the case of electricity produced in open-loop biomass facilities, small irrigation power facilities, landfill gas facilities, trash facilities, qualified hydropower facilities, and marine and hydrokinetic renewable energy facilities, section 45(b)(4)(A) requires the amount in effect under section 45(a)(1) (before rounding to the nearest 0.1 cent) to be reduced by one-half.

Section 45(c)(1) defines qualified energy resources as wind, closed-loop biomass, open-loop biomass, geothermal energy, solar energy, small irrigation power, municipal solid waste, qualified hydropower production, and marine and hydrokinetic renewable energy.

Section 45(d)(1) defines a qualified facility using wind to produce electricity as any facility owned by the taxpayer that is originally placed in service after December 31, 1993, and the construction of which begins before January 1, 2014. See section 45(e)(7) for rules relating to the inapplicability of the credit to electricity sold to utilities under certain contracts.

Section 45(d)(2)(A) defines a qualified facility using closed-loop biomass to produce electricity as any facility (i) owned by the taxpayer that is originally placed in service after December 31, 1992, and the construction of which begins before January 1, 2014; or (ii) owned by the taxpayer which before January 1, 2014, is originally placed in service and modified to use closed-loop biomass to co-fire with coal, with other biomass, or with both, but only if the modification is approved under the Biomass Power for Rural Development Programs or is part of a pilot project of the Commodity Credit Corporation as described in 65 Fed. Reg. 63052. For purposes of section 45(d)(2)(A)(ii), a facility shall be treated as modified before January 1, 2014, if the construction of such modification begins before such date. Section 45(d)(2)(C) provides that in the case of a qualified facility described in section 45(d)(2)(A)(ii), (i) the 10-year period referred to in section 45(a) is treated as beginning no earlier than the date of enactment of section 45(d)(2)(C)(i) (October 22, 2004); and (ii) if the owner of the facility is not the producer of the electricity, the person eligible for the credit allowable under section 45(a) is the lessee or the operator of the facility.

Section 45(d)(3)(A) defines a qualified facility using open-loop biomass to produce electricity as any facility owned by the taxpayer which (i) in the case of a facility using agricultural livestock waste nutrients, (I) is originally placed in service after the date of enactment of section 45(d)(3)(A)(i)(I) (October 22, 2004) and the construction of which begins before January 1, 2014, and (II) the nameplate capacity rating of which is not less than 150 kilowatts; and (ii) in the case of any other facility, the construction of which begins before January 1, 2014. In the case of any facility described in section 45(d)(3)(A), if the owner of the facility is not the producer of the electricity, section 45(d)(3)(C) provides that the person eligible for the credit allowable under section 45(a) is the lessee or the operator of the facility.

Section 45(d)(4) defines a qualified facility using geothermal or solar energy to produce electricity as any facility owned by the taxpayer which is originally placed in service after the date of enactment of section 45(d)(4) (October 22, 2004) and which, (A) in the case of a facility using solar energy, is placed in service before January 1, 2006, or (B) in the case of a facility using geothermal energy, the construction of which begins before January 1, 2014. A qualified facility using geothermal or solar energy does not include any property described in section 48(a)(3) the basis of which is taken into account by the taxpayer for purposes of determining the energy credit under section 48.

Section 45(d)(5) defines a qualified facility using small irrigation power to produce electricity as any facility owned by the taxpayer which is originally placed in service after the date of enactment of section 45(d)(5) (October 22, 2004) and before October 3, 2008.

Section 45(d)(6) defines a qualified facility using gas derived from the biodegradation of municipal solid waste to produce electricity as any facility owned by the taxpayer which is originally placed in service after the date of enactment of section 45(d)(6) (October 22, 2004) and the construction of which begins before January 1, 2014.

Section 45(d)(7) defines a qualified facility (other than a facility described in section 45(d)(6)) that burns municipal solid waste to produce electricity as any facility owned by the taxpayer which is originally placed in service after the date of enactment of section 45(d)(7) (October 22, 2004) and the construction of which begins before January 1, 2014. A qualified facility burning municipal solid waste includes a new unit placed in service in connection with a facility placed in service on or before the date of enactment of section 45(d)(7), but only to the extent of the increased amount of electricity produced at the facility by reason of such new unit.

Section 45(d)(8) provides in the case of a facility that produces refined coal, the term "refined coal production facility" means (A) with respect to a facility producing steel industry fuel, any facility (or any modification to a facility) which is placed in service before January 1, 2010, and (B) with respect to any other facility producing refined coal, any facility placed in service after the date of the enactment of the American Jobs Creation Act of 2004 (October 22, 2004) and before January 1, 2012.

Section 45(d)(9) defines a qualified facility producing qualified hydroelectric production described in section 45(c)(8) as (i) any facility producing incremental hydropower production, but only to the extent of its incremental hydropower production attributable to efficiency improvements or additions to capacity described in section 45(c)(8)(B) placed in service after the date of enactment of section 45(d)(9)(A)(i) (August 8, 2005) and before January 1, 2014; and (ii) any other facility placed in service after the date of enactment of section 45(d)(9)(A)(ii) (August 8, 2005) and the construction of which begins before January 1, 2014. Section 45(d)(9)(B) provides that in the case of a qualified facility described in section 45(d)(9)(A), the 10-year period referred to in section 45(a) is treated as beginning on the date the efficiency improvements or additions to capacity are placed in service. Section 45(d)(9)(C) provides that for purposes of section 45(d)(9)(A)(i), an efficiency improvement or addition to capacity is treated as placed in service before January 1, 2014, if the construction of such improvement or addition begins before such date.

Section 45(d)(10) provides in the case of a facility that produces Indian coal, the term "Indian coal production facility" means a facility which is placed in service before January 1, 2009.

Section 45(d)(11) provides in the case of a facility producing electricity from marine and hydrokinetic renewable energy, the term "qualified facility" means any facility owned by the taxpayer which (A) has a nameplate capacity rating of at least 150 kilowatts, and (B) which is originally placed in service on or after the date of the enactment of section 45(d)(11)(B) (October 3, 2008) and the construction of which begins before January 1, 2014.

Section 45(e)(8)(A) provides that the refined coal production credit is an amount equal to $4.375 per ton of qualified refined coal (i) produced by the taxpayer at a refined coal production facility during the 10-year period beginning on the date the facility was originally placed in service, and (ii) sold by the taxpayer (I) to an unrelated person and (II) during the 10-year period and the tax year. Section 45(e)(8)(B) provides that the amount of credit determined under section 45(e)(8)(A) is reduced by an amount which bears the same ratio to the amount of the increase as (i) the amount by which the reference price of fuel used as feedstock (within the meaning of section 45(c)(7)(A)) for the calendar year in which the sale occurs exceeds an amount equal to 1.7 multiplied by the reference price for such fuel in 2002, bears to (ii) $8.75. Section 45(e)(8)(D)(ii)(I) provides that in the case of a taxpayer who produces steel industry fuel, section 45(e)(8)(A) shall be applied by substituting "$2 per barrel-of-oil equivalent" for "$4.375 per ton." Section 45(e)(8)(D)(ii)(II) provides that in lieu of the 10-year period referred to in sections 45(e)(8)(A)(i) and 45(e)(8)(A)(ii)(II), the credit period shall be the period beginning on the later of the date such facility was originally placed in service, the date the modifications described in section 45(e)(8)(D)(iii) were placed in service, or October 1, 2008, and ending on the later of December 31, 2009, or the date which is 1 year after the date such facility or the modifications described in section 45(e)(8)(D)(iii) were placed in service. Section 45(e)(8)(D)(ii)(III) provides that section 45(e)(8)(B) (dealing with the phaseout of the credit) will not apply.

Section 45(e)(10)(A) provides in the case of a producer of Indian coal, the credit determined under section 45 for any taxable year shall be increased by an amount equal to the applicable dollar amount per ton of Indian coal (i) produced by the taxpayer at an Indian coal production facility during the 8-year period beginning on January 1, 2006, and (ii) sold by the taxpayer (I) to an unrelated person, and (II) during such 8-year period and such taxable year.

Section 45(e)(10)(B)(i) defines "applicable dollar amount" for any taxable year as (I) $1.50 in the case of calendar years 2006 through 2009, and (II) $2.00 in the case of calendar years beginning after 2009.

Section 45(e)(2)(A) requires the Secretary to determine and publish in the Federal Register each calendar year the inflation adjustment factor and the reference price for the calendar year. The inflation adjustment factors and the reference prices for the 2013 calendar year were published in the Federal Register on April 3, 2013.

Section 45(e)(2)(B) defines the inflation adjustment factor for a calendar year as the fraction the numerator of which is the GDP implicit price deflator for the preceding calendar year and the denominator of which is the GDP implicit price deflator for the calendar year 1992. The term "GDP implicit price deflator" means the most recent revision of the implicit price deflator for the gross domestic product as computed and published by the Department of Commerce before March 15 of the calendar year.

Section 45(e)(2)(C) provides that the reference price is the Secretary's determination of the annual average contract price per kilowatt hour of electricity generated from the same qualified energy resource and sold in the previous year in the United States. Only contracts entered into after December 31, 1989, are taken into account.

Under section 45(e)(8)(C), the determination of the reference price for fuel used as feedstock within the meaning of section 45(c)(7)(A) is made according to rules similar to the rules under section 45(e)(2)(C).

Under section 45(e)(10)(B)(ii), in the case of any calendar year after 2006, each of the dollar amounts under section 45(e)(10)(B)(i) shall be equal to the product of such dollar amount and the inflation

adjustment factor determined under section 45(e)(2)(B) for the calendar year, except that section 45(e)(2)(B) shall be applied by substituting 2005 for 1992.

INFLATION ADJUSTMENT FACTORS AND REFERENCE PRICES

The inflation adjustment factor for calendar year 2013 for qualified energy resources and refined coal is 1.5063. The inflation adjustment factor for Indian coal is 1.1538.

The reference price for calendar year 2013 for facilities producing electricity from wind (based upon information provided by the Department of Energy) is 4.53 cents per kilowatt hour. The reference prices for fuel used as feedstock within the meaning of section 45(c)(7)(A), relating to refined coal production (based upon information provided by the Department of Energy) are $31.90 per ton for calendar year 2002 and $58.23 per ton for calendar year 2013. The reference prices for facilities producing electricity from closed-loop biomass, open-loop biomass, geothermal energy, solar energy, small irrigation power, municipal solid waste, qualified hydropower production, and marine and hydrokinetic energy have not been determined for calendar year 2013.

PHASEOUT CALCULATION

Because the 2013 reference price for electricity produced from wind (4.53 cents per kilowatt hour) does not exceed 8 cents multiplied by the inflation adjustment factor, the phaseout of the credit provided in section 45(b)(1) does not apply to such electricity sold during calendar year 2013. Because the 2013 reference price of fuel used as feedstock for refined coal ($58.23) does not exceed the $31.90 reference price of such fuel in 2002 multiplied by the inflation adjustment factor and 1.7, the phaseout of credit provided in section 45(e)(8)(B) does not apply to refined coal sold during calendar year 2013. Further, for electricity produced from closed-loop biomass, open-loop biomass, geothermal energy, solar energy, small irrigation power, municipal solid waste, qualified hydropower production, and marine and hydrokinetic energy, the phaseout of credit provided in section 45(b)(1) does not apply to such electricity sold during calendar year 2013.

CREDIT AMOUNT BY QUALIFIED ENERGY RESOURCE AND FACILITY, REFINED COAL, AND INDIAN COAL

As required by section 45(b)(2), the 1.5 cent amount in section 45(a)(1), the 8 cent amount in section 45(b)(1), the $4.375 amount in section 45(e)(8)(A) and the $2.00 amount in section 45(e)(8)(D) are each adjusted by multiplying such amount by the inflation adjustment factor for the calendar year in which the sale occurs. If any amount as increased under the preceding sentence is not a multiple of 0.1 cent, such amount is rounded to the nearest multiple of 0.1 cent. In the case of electricity produced in open-loop biomass facilities, small irrigation power facilities, landfill gas facilities, trash facilities, qualified hydropower facilities, and marine and hydrokinetic renewable energy facilities, section 45(b)(4)(A) requires the amount in effect under section 45(a)(1) (before rounding to the nearest 0.1 cent) to be reduced by one-half. Under the calculation required by section 45(b)(2), the credit for renewable electricity production for calendar year 2013 under section 45(a) is 2.3 cents per kilowatt hour on the sale of electricity produced from the qualified energy resources of wind, closed-loop biomass, geothermal energy, and solar energy, and 1.1 cents per kilowatt hour on the sale of electricity produced in open-loop biomass facilities, small irrigation power facilities, landfill gas facilities, trash facilities, qualified hydropower facilities, and marine and hydrokinetic energy facilities. Under the calculation required by section 45(b)(2), the credit for refined coal production for calendar year 2013 under section 45(e)(8)(A) is $6.590 per ton on the sale of qualified refined coal. The credit for Indian coal production for calendar year 2013 under section 45(e)(10)(B) is $2.308 per ton on the sale of Indian coal.

DRAFTING AND CONTACT INFORMATION

The principal author of this notice is Martha M. Garcia of the Office of Associate Chief Counsel (Passthroughs & Special Industries). For further information regarding this notice contact Martha M. Garcia on (202) 622–3110 (not a toll-free call).

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26 CFR 1.263(a)–1: Capital expenditures; in general.
(Also: §§ 162 and 446)

Rev. Proc. 2013–24

SECTION 1. PURPOSE

This revenue procedure provides definitions of units of property and major components taxpayers may use to determine whether expenditures to maintain, replace, or improve steam or electric power generation property must be capitalized under § 263(a) of the Internal Revenue Code. This revenue procedure also provides procedures for obtaining automatic consent to change to a method of accounting that uses all, or some of, the unit of property definitions provided.

SECTION 2. BACKGROUND

.01 Taxpayers that generate steam or electric power incur significant expenditures to maintain, replace, and improve generation property. Whether these expenditures are deductible as repairs under § 162 or must be capitalized as improvements under § 263(a) depends on whether the expenditures materially increase the value of the property or appreciably prolong its life. *See* § 1.162–4 of the Income Tax Regulations. In general, under § 263(a) the cost of replacing a unit of property or major component must be capitalized.

.02 A generation plant is composed of numerous functionally interdependent items of machinery and equipment, and it can be difficult to identify which items constitute discrete units of property, major components, or something else. As a consequence, taxpayers and the Internal Revenue Service (Service) often disagree about whether the cost to replace a particular item is a capital or deductible expense.

.03 To minimize disputes regarding the deductibility or capitalization of expenditures to maintain, replace, or improve generation property, this revenue procedure provides "unit of property" and "major

component" definitions which, if used by a taxpayer as provided in the revenue procedure, will not be challenged by the Service.

.04 A taxpayer's method for determining whether an expenditure is deductible or is capitalizable, including unit of property and major component definitions, is a method of accounting under § 446. Section 446(e) and § 1.446–1(e) require taxpayers to secure the consent of the Commissioner before changing a method of accounting for Federal income tax purposes. Section 1.446–1(e)(3)(ii) authorizes the Commissioner to prescribe administrative procedures setting forth the limitations, terms, and conditions necessary to permit a taxpayer to obtain consent to change a method of accounting.

SECTION 3. SCOPE

.01 *Applicability*. This revenue procedure applies to a taxpayer that has a depreciable interest in steam or electric power generation property primarily used in the trade or business of generating or selling steam (or steam in the form of heat) or electricity.

.02 *Inapplicability*. This revenue procedure applies only to property defined in Appendix A of this revenue procedure. Specifically, this revenue procedure does not apply to property used to produce electricity from alternative energy sources such as wind or photovoltaic.

.03 *Scope determined at entity level for consolidated groups and passthrough entities*. The determination of whether a taxpayer is within the scope of this revenue procedure is made by each member of a consolidated group, by a partnership, or by an S corporation.

SECTION 4. DEFINITIONS

The following definitions apply solely for purposes of this revenue procedure:

.01 *Generation property*. "Generation property" means real and personal property that is used to generate steam or electricity and transmit that steam or electricity to the transmission and distribution network. Generation property excludes the transmission and distribution network. Examples of generation property include coal-fired, natural gas-fired, oil-fired, hydroelectric, and nuclear-powered power stations. Generation property does not include real or personal property not directly used to generate, conduct, or control steam or electricity at any point within a power station. For example, generation property does not include an accessory building (such as an administrative, training, or laboratory building), an office building, an administrative office section of a power station, or furniture and equipment used in such buildings or offices.

.02 *Power station*. A "power station" is generally, at a minimum, one generating unit — that is, the combination of a power source (some means of providing kinetic energy to the turbine, such as a boiler or dam), a turbine, and a generator. A power station may combine multiple generating units. However, a heat-only boiler station for generating steam power also qualifies as a power station for purposes of this revenue procedure. Due to design variations, an individual power station may or may not contain all of the units of property or major components listed in Appendix A.

SECTION 5. UNITS OF PROPERTY AND MAJOR COMPONENTS OF GENERATION PROPERTY

.01 *In general*. If used in accordance with the requirements set forth in this revenue procedure, the unit of property or major component determinations provided in Appendix A of this revenue procedure will not be challenged by the Service under § 263(a) and the regulations thereunder.

.02 *Universal use of units of property not required*. A taxpayer within the scope of this revenue procedure is not required to use all the unit of property definitions provided in Appendix A of this revenue procedure and, therefore, may use one or more of the unit of property definitions provided. However, this revenue procedure does not apply to property for which a taxpayer does not use a unit of property definition provided in Appendix A. A taxpayer that uses a unit of property definition provided in Appendix A must also use the major component definition(s) listed in Appendix A for that unit of property. Additionally, a taxpayer may not rely on a major component definition without using the corresponding unit of property definition. Once used, a unit of property definition and the corresponding major component definition(s) for that unit of property apply to all similar assets, including similar electric generation property subsequently acquired in an applicable asset acquisition as defined in § 1060 or in a transaction to which § 338(h)(10) applies.

.03 *Limitation*. A taxpayer may not rely on the unit of property definitions provided in this revenue procedure for any other purpose of the Code or Regulations, including for determining the unit of property under other Code sections (for example, § 263A), or determining the asset for depreciation purposes (including placed in service dates, retirements, dispositions, or classification under § 168(e) or Rev. Proc. 87–56, 1987–2 C.B. 674), for the same or similar type of assets used in electric power generation.

.04 *Example*. X is an electric utility company that files its Federal income tax return on a calendar year basis. X operates a power plant to generate electricity and uses the unit of property and major component definitions provided by this revenue procedure for each of the following items of property: (1) a structure that is not a building under § 1.48–1(e)(1), (2) four pulverizers that grind coal, (3) one boiler that produces steam, (4) one turbine that converts the steam into mechanical energy, and (5) one generator that converts mechanical energy into electrical energy. In addition, the turbine contains a series of blades that cause the turbine to rotate when affected by the steam. Under section 5 and Appendix A, section 2, of this revenue procedure, X treats the structure (Appendix A, section 2.02), the boiler (Appendix A, section 2.03), the turbine (Appendix A, section 2.11), the generator (Appendix A, section 2.12), and each of the four pulverizers (Appendix A, section 2,18) as separate units of property. X is not required to treat components, such as the turbine blades, as separate units of property, but under Appendix A, section 2.11(2)(c), each complete set of blades in each section of the turbine must be treated as a major component.

SECTION 6. CHANGE IN METHOD OF ACCOUNTING

.01 *In general*. A change to use the unit of property and major component definitions provided by this revenue procedure is a change in method of accounting to which the provisions of §§ 446 and 481, and the regulations thereunder, apply. A taxpayer that wants to change to the method of accounting described in this revenue procedure must use the automatic change in method of accounting provisions in Rev. Proc. 2011–14, 2011–4 I.R.B. 330, or its successor, as modified by this revenue procedure.

.02 *Extrapolation*. Taxpayers applying the method of accounting provided in this revenue procedure may extrapolate re-

sults to determine the § 481(a) adjustment amount for certain years by following the relevant procedures provided in Appendix B to this revenue procedure. Extrapolation methodologies not permitted in Appendix B to this revenue procedure are not permitted under the method of accounting.

.03 *Automatic change*. Rev. Proc. 2011–14 is modified to add new section 3.20 to the APPENDIX, to read as follows:

.20 *Method of accounting under Rev. Proc. 2013–24 for taxpayers in the business of generating steam or electric power*.

(1) *Description of change*. This change applies to a taxpayer that is within the scope of Rev. Proc. 2013–24 and wants to change its treatment of generation property expenditures to use all, or some of, the unit of property definitions and the corresponding major component definitions described in Rev. Proc. 2013–24.

(2) *Waiver of scope limitations*. The scope limitations in section 4.02 of this revenue procedure do not apply to an eligible taxpayer that changes to the method of accounting provided in Rev. Proc. 2013–24 for its first, second, or third taxable year ending after December 30, 2012.

(3) *Section 481(a) adjustment*.

(a) A taxpayer must take the entire net § 481(a) adjustment into account (whether positive or negative) in computing taxable income in the year of change. For guidance regarding the use of extrapolation in computing a § 481(a) adjustment, see Rev. Proc. 2013–24, section 6.02 and Appendix B.

(b) A taxpayer changing to this method of accounting must not include in the § 481(a) adjustment any amount attributable to property for which the taxpayer elected to apply the repair allowance under § 1.167(a)–11(d)(2) for any taxable year in which the repair allowance election was made.

(4) *Ogden copy of Form 3115 required in lieu of national office copy*. A taxpayer changing its method of accounting under section 3.20 of the APPENDIX must file a signed copy of its completed Form 3115 with the IRS in Ogden, UT (Ogden copy), in lieu of filing the national office copy no earlier than the first day of the year of change and no later than the date the taxpayer files the original Form 3115 with its Federal income tax return for the year of change. *See* sections 6.02(3)(a)(ii)(B) (providing the general rules) and section 6.02(7)(b) (providing the mailing address) of this revenue procedure.

(5) *Designated automatic accounting method change numbers*. The designated automatic accounting method change number for a change to the method of accounting provided in Rev. Proc. 2013–24 is "182."

(6) *Contact information*. For further information regarding a change under this section, contact Alan S. Williams at (202) 622–4950 (not a toll free call).

SECTION 7. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2011–14 is modified to include the accounting method change in this revenue procedure in section 3 of the Appendix.

SECTION 8. EFFECTIVE DATE

This revenue procedure is effective for taxable years ending on or after December 31, 2012.

SECTION 9. DRAFTING INFORMATION

The principal author of this revenue procedure is Alan S. Williams of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue procedure contact Alan S. Williams at 202–622–4950 (not a toll free call).

APPENDIX A

Unit of Property & Major Component Definitions

SECTION 1. IN GENERAL

.01 *In general*. Listed throughout this Appendix are units of property and major components for specified power stations. Due to design variations, an individual power station may not contain all of the units of property or major components listed for that particular type of power station. A power station may combine multiple generating units. A generating unit generally includes, at a minimum, a power source, a turbine, and a generator. A unit of property that is shared by more than one generating unit is a single unit of property.

.02 *Fans and pumps*. Unless otherwise stated, all fans and pumps include the electric motor that powers the fan or pump.

.03 *Water conveyance system*. A water conveyance system includes all piping, fittings, valves, pumps, and other equipment included in the unit of property through which water or steam passes, unless identified with another major component.

.04 *Instrumentation and controls*. Instrumentation and controls includes both those in the control room and those adjacent to the unit of property for which they are a major component.

.05 *Generating unit determination*. For purposes of this revenue procedure, the units of property for a power station are determined on a generating-unit-by-generating-unit basis.

SECTION 2. UNITS OF PROPERTY FOR COAL-FIRED POWER STATIONS

.01 *In general*. For coal-fired power stations, the Service will not challenge any of the following unit of property or major component determinations for purposes of the application of § 263(a) and the regulations thereunder.

.02 *Station property*. (1) Station property serving a generating unit constitutes a single unit of property. Station property is each structure that physically supports and/or encloses the generating unit equipment, along with the structure's associated systems and support facilities. It does not include accessory buildings (such as administrative, training, or laboratory buildings) or administrative office sections of the power station and systems that support administrative space (such as heating, air conditioning and ventilation, plumbing, and the electrical system within the administrative space). As noted in Appendix A, section 1.01 above, if a unit of property is shared by more than one generating unit, the unit of property is a single unit of property. However, in a power station with two generating units, if a single structure and its associated systems solely supports generating unit 1, another structure and its associated systems solely supports generating unit 2, and a third structure and its associated systems supports both generating units 1 and 2, there are three separate units of station property (the structure and its associated systems solely supporting generating unit 1, the structure and its associated systems solely supporting generating unit 2, and the structure and its associated systems supporting both generating units 1 and 2).

(2) Station property contains the following major components:

(a) turbine building crane,

(b) all other overhead cranes, and

(c) all compressed air systems.

.03 *Main boiler*. (1) Each main boiler constitutes a single unit of property. The main boiler is the equipment where coal is burned and heat is transferred to water in a process that creates steam.

(2) Each main boiler contains the following major components:

(a) primary furnace, including all tubing, baffles, and valves,

(b) economizer,

(c) steam drum,

(d) reheater,

(e) superheater,

(f) convection pass,

(g) complete burner system, and

(h) instrumentation and controls.

.04 *Auxiliary boiler*. (1) Each auxiliary boiler constitutes a single unit of property. The auxiliary boiler is the equipment that supplies steam from a source independent of the main boiler. The auxiliary boiler is generally used to power the turbines during the process of starting the operation of the generating unit before the main boiler is operating.

(2) The auxiliary boiler has no major components.

.05 *Combustion air system*. (1) Each combustion air system constitutes a single unit of property. The combustion air system is the equipment that controls the air draft for efficient burning of coal and the discharge of flue gas.

(2) Each combustion air system contains the following major components:

(a) forced draft fan,

(b) induced draft fan,

(c) induced draft booster fan,

(d) ductwork, including the combustion air ductwork, the flue gas ductwork, and all related expansion joints,

(e) air preheater, and

(f) instrumentation and controls.

.06 *Flue-gas desulfurization (FGD) scrubber (SO_x removal) system.* (1) Each Flue-gas desulfurization (FGD) scrubber (SO_x removal) system constitutes a single unit of property. The FGD scrubber system is the equipment that removes forms of sulfur oxide (SO_x) from flue gas.

(2) FGD scrubber system contains the following major components:

(a) FGD sorbent handling system, which receives, stores, and transports the sorbent,

(b) sorbent delivery system, which includes the crushing and slicing equipment,

(c) FGD vessel,

(d) scrubber circulating pumps,

(e) scrubber wastewater removal system, and

(f) instrumentation and controls.

.07 *NO_x removal system.* (1) Each NO_x removal system constitutes a single unit of property. The NO_x removal system is the equipment that removes nitrogen oxides (NO_x) from the flue gas.

(2) The NO_x removal system contains the following major components:

(a) selective catalytic reducer box, and

(b) ammonia/urea transport system, including the transport and injection equipment, and

(c) instrumentation and controls.

.08 *Activated carbon handling and injection system.* (1) Each activated carbon handling and injection system constitutes a single unit of property. The activated carbon handling and injection system is the equipment that removes mercury (Hg) by the injection of carbon into the flue gas.

(2) The activated carbon handling and injection system contains one major component: the instrumentation and controls.

.09 *Continuous emissions monitoring system.* (1) Each continuous emissions monitoring system constitutes a single unit of property. The continuous emissions monitoring system is the equipment that monitors emissions at all times.

(2) The continuous emissions monitoring system contains one major component: the instrumentation and controls.

.10 *Condensate/feedwater system.* (1) Each condensate/feedwater system constitutes a single unit of property. The condensate/feedwater system is the equipment that forms a closed loop through which the treated feedwater circulates from the condenser to the steam drum within the boiler, through the turbines, and back to the condenser.

(2) The condensate/feedwater system contains the following major components, the number of which will vary depending on the number of boiler feed pumps, boiler feed pump turbines, and condensate pumps in the system:

(a) each boiler feed pump turbine, if the boiler feed pump is powered by a steam turbine,

(b) each boiler feed pump,

(c) the deaerater system,

(d) the primary condensate pump,

(e) the water conveyance system,

(f) the evaporator system, and

(g) instrumentation and controls.

.11 *Turbine.* (1) Each turbine constitutes a single unit of property. The turbine is the equipment that extracts thermal power from pressurized steam and converts the energy into a rotary motion, which motion is used to power the generator.

(2) The turbine contains the following major components, the number of which will vary, depending on the number of pressure sections in the turbine:

(a) shell and casing,

(b) instrumentation and controls,

(c) complete set of blades in each section of the turbine (*e.g.*, if turbine has high, medium, and low-pressure sections, there are three major components: one set of blades for each section of the turbine), and

(d) shaft section in each section of the turbine (*e.g.*, if turbine has high, medium, and low-pressure sections, there are three major components, one shaft for each section of the turbine).

.12 *Generator.* (1) Each generator constitutes a single unit of property. The generator is the equipment that converts the mechanical energy produced by the turbine to electrical energy.

(2) The generator contains the following major components:

(a) stator, including the windings, shell, and casing,

(b) rotor, including core and windings, and

(c) instrumentation and controls.

.13 *Condenser and cooling water system.* (1) Each condenser and cooling water system constitutes a single unit of property. The condenser and cooling water system is the equipment that converts the steam in the condensate/feedwater system back to water as it passes into the condenser.

(2) The condenser and cooling water system contains the following major components, the number of which will vary, depending on the number of circulating water pumps used to draw water from a lake, river, or ocean or to feed one or more cooling water towers:

(a) condenser,

(b) cooling tower,

(c) water conveyance system,

(d) the primary circulating water pump that draws from a unique water source (such as a lake, river, or ocean) for a once-through system, or which feeds one or more cooling water towers, and

(e) instrumentation and controls.

.14 *Water treatment system*. (1) Each water treatment system constitutes a single unit of property. The water treatment system is generally the equipment that removes minerals and other impurities in the water, which is used in the condensate/feedwater system and the condenser and cooling water system.

(2) The water treatment system contains the following major components:

(a) filtration system,

(b) desalinization system,

(c) demineralization system,

(d) disinfection system, including chlorination,

(e) sedimentation system, and

(f) instrumentation and controls.

.15 *Water supply system*. (1) Each water supply system constitutes a single unit of property. The water supply system is the equipment that supplies water to a generating unit.

(2) The water supply system contains the following major components:

(a) each storage tank,

(b) water conveyance system, and

(c) instrumentation and controls.

.16 *Wastewater system*. (1) Each wastewater system constitutes a single unit of property. A wastewater system that integrates multiple treatment processes into one system is a single unit of property. Wholly separate and discrete wastewater systems are treated as separate units of property. The wastewater system is the equipment that treats and disposes of wastewater.

(2) The wastewater system contains the following major components:

(a) each treatment tank,

(b) wastewater conveyance system, and

(c) instrumentation and controls.

.17 *Fuel storage and handling system*. (1) Each fuel storage and handling system constitutes a single unit of property. The fuel storage and handling system is the equipment that receives the coal, stores it, and delivers it to the boiler.

(2) The fuel storage and handling system contains the following major components:

(a) coal handling systems,

(b) coal conveyors,

(c) each silo,

(d) coal handling stations, and

(e) instrumentation and controls.

.18 *Pulverizer*. (1) Each pulverizer constitutes a separate unit of property. The pulverizer is the equipment that grinds the coal into a finer substance to improve combustion.

(2) The pulverizer has no major components.

.19 *Ash handling system*. (1) Each ash handling system constitutes a single unit of property. The ash handling system is the equipment that captures, removes, transports, and stores bottom ash and fly ash, which are particulates created by the burning of coal.

(2) The ash handling system contains the following major components:

(a) each fly ash pond,

(b) bottom ash handling system,

(c) electrostatic precipitator,

(d) bag house, including bags,

(e) fly ash handling system, and

(f) instrumentation and controls.

.20 *Auxiliary power system*. (1) Each auxiliary power system constitutes a single unit of property. The auxiliary power system is the equipment that provides back-up electrical power for a generating unit, which is needed to restart the generating unit after a shutdown.

(2) The auxiliary power system contains one major component: each auxiliary generator.

.21 *Simulator*. (1) Each simulator constitutes a single unit of property. The simulator is the equipment that is used to train plant personnel in the operations (including safety and rescue) of the power plant.

(2) The simulator has no major components.

.22 *Main step-up transformer*. (1) Each main step-up transformer constitutes a single unit of property. The main step-up transformer is equipment that increases the voltage of the electricity generated at the generation plant to a voltage level needed for the transmission of the electricity.

(2) The main step-up transformer has no major components.

.23 *Ventilation system*. (1) Each ventilation system serving a unit of station property, as defined in subsection 2.02 above, constitutes a single unit of property. The ventilation system is the equipment that circulates and filters the air in the station property.

(2) No special rule is provided under this revenue procedure for the major components of the ventilation system. The major components of the ventilation system are determined under the general principles of § 263(a).

.24 *Station electrical delivery system*. (1) A power station's electrical delivery system constitutes a single unit of property. The station electrical delivery system is the equipment that distributes electrical power in the power plant.

(2) No special rule is provided under this revenue procedure for the major components of the station electrical system. The major components of the station electrical delivery system are determined under the general principles of § 263(a).

.25 *Safety system*. (1) A power station's safety equipment constitutes a single unit of property. The safety system is the equipment that alerts power plant personnel to potentially hazardous conditions (including sirens, alarms, and evacuation systems).

(2) No special rule is provided under this revenue procedure for the major components of the safety system. The major components of the safety system are determined under the general principles of § 263(a).

.26 *Fire protection system*. (1) A power station's fire protection system constitutes a single unit of property. The fire protection system is the equipment that detects, suppresses, and extinguishes fires.

(2) No special rule is provided under this revenue procedure for the major components of the fire protection system. The major components of the fire protection system are determined under the general principles of § 263(a).

.27 *Accessory Buildings*. (1) Each accessory building constitutes a single unit of property. An accessory building is a building located at a power plant that is not station property as defined in subsection 2.02 above. For example, laboratory buildings, training buildings, warehouses, administrative buildings, pre-admittance buildings, and maintenance shops are accessory buildings.

(2) No special rule is provided under this revenue procedure for the major components of the accessory buildings. The major components or substantial structural parts of an accessory building are determined under the general principles of § 263(a).

SECTION 3. UNITS OF PROPERTY FOR NATURAL GAS OR OIL FIRED POWER STATIONS

.01 *In general*. For natural gas or oil fired power stations, the Service will not challenge any of the following unit of property or major component determinations for purposes of the application of § 263(a) and the regulations thereunder.

.02 *Station property*. (1) Station property serving a natural gas or oil fired generating unit constitutes a single unit of property. Station property is each structure that physically supports and/or encloses the generating unit equipment, and associated systems and support facilities. It does not include accessory buildings (such as administrative, training, or laboratory buildings) or administrative office sections of the power station and systems that support administrative space (such as heating, air conditioning and ventilation, plumbing, and the electrical system within the administrative space). As noted in Appendix A, section 1.01 above, if a unit of property is shared by more than one generating unit, the unit of property is a single unit of property. However, in a power station with two generating units, if a single structure and its associated systems solely supports generating unit 1, another structure and its associated systems solely supports generating unit 2, and a third structure and its associated systems supports both generating units 1 and 2, there are three separate units of station property (the structure and its associated systems solely supporting generating unit 1, the structure and its associated systems solely supporting generating unit 2, and the structure and its associated systems supporting both generating units 1 and 2).

(2) Station property contains the following major components:

(a) turbine building crane,

(b) all other overhead cranes, and

(c) all compressed air systems.

.03 *Main Boiler*. (1) Each main boiler constitutes a single unit of property. The main boiler is the equipment where natural gas or oil is burned and heat is transferred to water in a process that creates steam. This unit of property is not included with either single-cycle or combined-cycle power stations.

(2) Each main boiler contains the following major components:

(a) primary furnace, including all tubing, baffles, and valves,

(b) economizer,

(c) steam drum,

(d) reheater,

(e) superheater,

(f) convection pass,

(g) complete burner system, and

(h) instrumentation and controls.

.04 *Auxiliary boiler*. (1) Each auxiliary boiler constitutes a single unit of property. The auxiliary boiler is the equipment that supplies steam from a source independent of the main boiler. The auxiliary boiler is generally used to power the turbines during the process of starting the operation of the generation plant before the main boiler is operating.

(2) The auxiliary boiler has no major components.

.05 *Combustion air system*. (1) Each combustion air system constitutes a single unit of property. The combustion air system is the equipment that controls the air draft for efficient burning of natural gas or oil and the discharge of flue gas.

(2) The combustion air system contains the following major components:

(a) forced draft fan,

(b) induced draft fan,

(c) ductwork, including the combustion air ductwork, the flue gas ductwork, and all related expansion joints,

(d) air preheater, and

(e) instrumentation and controls.

.06 *NO_x removal system*. (1) Each NOx removal system constitutes a single unit of property. The NO_x removal system is the equipment that removes nitrogen oxides (NO_x) from the flue gas.

(2) The NO_x removal system contains the following major components:

(a) selective catalytic reducer box,

(b) ammonia/urea transport system, including the transport and injection equipment, and

(c) instrumentation and controls.

.07 *Continuous emissions monitoring System*. (1) Each continuous emissions monitoring system constitutes a single unit of property. The continuous emissions monitoring system is the equipment that monitors emissions at all times.

(2) The continuous emissions monitoring system contains one major component: the instrumentation and controls.

.08 *Condensate/feedwater system*. (1) Each condensate/feedwater system constitutes a single unit of property. The condensate/feedwater system is the equipment that forms a closed loop through which the treated feedwater circulates from the condenser to the steam drum within the boiler, through the turbines, and back to the condenser.

(2) The condensate/feedwater system contains the following major components, the number of which will vary depending on the number of boiler feed pumps, boiler feed pump turbines, and condensate pumps in the system:

(a) each boiler feed pump turbine, if the boiler feed pump is powered by a steam turbine,

(b) each boiler feed pump,

(c) the deaerater system,

(d) the primary condensate pump,

(e) the water conveyance system,

(f) the evaporator system, and

(g) the instrumentation and controls.

.09 *Turbine*. (1) Each turbine constitutes a single unit of property. The turbine is the equipment that extracts thermal power from pressurized steam and converts the energy into a rotary motion, which motion is used to power the generator.

(2) The turbine contains the following major components, the number of which will vary, depending on the number of pressure sections in the turbine:

(a) shell and casing,

(b) instrumentation and controls,

(c) complete set of blades in each section of the turbine (e.g., if the turbine has high, medium, and low-pressure sections, there are three major components: one set of blades for each section of the turbine),

(d) shaft section in each section of the turbine (e.g., if the turbine has high, medium, and low-pressure sections, there are three major components: one shaft section for each section of the turbine).

.10 *Generator*. (1) Each generator constitutes a single unit of property. The generator is the equipment that converts the mechanical energy produced by the turbine to electrical energy.

(2) The generator contains the following major components:

(a) stator, including the windings, shell, and casing,

(b) rotor, including core and windings, and

(c) instrumentation and controls.

.11 *Condenser and cooling water system*. (1) Each condenser and cooling water system constitutes a single unit of property. The condenser and cooling water system is the equipment that converts the steam in the condensate/feedwater system back to water as it passes into the condenser.

(2) The condenser and cooling water system contains the following major components, the number of which will vary, depending on the number of circulating water pumps used to draw water from a lake, river, or ocean or to feed one or more cooling water towers:

(a) condenser,

(b) cooling tower,

(c) water conveyance system,

(d) each primary circulating water pump that draws from a unique water source (such as a lake, river, or ocean) for a once-through system, or which feeds one or more cooling water towers, and

(e) instrumentation and controls.

.12 *Water treatment system*. (1) Each water treatment system constitutes a single unit of property. The water treatment system is generally the equipment that removes minerals and other impurities in the water, which is used in the condensate/feedwater system and the condenser and cooling water system.

(2) The water treatment system contains the following major components:

(a) filtration system,

(b) desalinization system,

(c) demineralization system,

(d) disinfection system, including chlorination,

(e) sedimentation system, and

(f) instrumentation and controls.

.13 *Water supply system*. (1) Each water supply system constitutes a single unit of property. The water supply system is the equipment that supplies water to a generating unit.

(2) The water supply system contains the following major components:

(a) each storage tank,

(b) water conveyance system, and

(c) instrumentation and controls.

.14 *Wastewater system*. (1) Each wastewater system constitutes a single unit of property. A wastewater system that integrates multiple treatment processes into one system is a single unit of property. Wholly separate and discrete wastewater systems are treated as separate units of property. The wastewater system is the equipment that treats and disposes of wastewater.

(2) The wastewater system contains the following major components:

(a) each treatment tank,

(b) wastewater conveyance system, and

(c) instrumentation and controls.

.15 *Fuel storage and handling system*. (1) Each fuel storage and handling system constitutes a single unit of property. The fuel storage and handling system is the equipment that receives the natural gas or oil, stores it, and delivers it to the boiler.

(2) The fuel storage and handling system contains the following major components:

(a) each fuel storage tank,

(b) fuel transport system, and

(c) instrumentation and controls.

.16 *Auxiliary power system*. (1) Each auxiliary power system constitutes a single unit of property. The auxiliary power system is the equipment that provides back-up electrical power for a generating unit, which is needed to restart the generating unit after a shutdown.

(2) The auxiliary power system contains one major component: each auxiliary generator.

.17 *Simulator*. (1) Each simulator constitutes a single unit of property. The simulator is the equipment that is used to train plant personnel in the operations (including safety and rescue) of the power plant.

(2) The simulator has no major components.

.18 *Main step-up transformer*. (1) Each main step-up transformer constitutes a single unit of property. The main step-up transformer is equipment that increases the voltage of the electricity generated at the generation plant to a voltage level needed for the transmission of the electricity.

(2) The main step-up transformer has no major components.

.19 *Ventilation system*. (1) Each ventilation system serving a unit of station property, as defined in subsection 3.02 above, constitutes a single unit of property. The ventilation system is the equipment that circulates and filters the air in the station property.

(2) No special rule is provided under this revenue procedure for the major components of the ventilation system. The major components of the ventilation system are determined under the general principles of § 263(a).

.20 *Station electrical delivery system*. (1) A power station's electrical delivery system constitutes a single unit of property. The station electrical delivery system is the equipment that distributes electrical power in the generation plant.

(2) No special rule is provided under this revenue procedure for the major components of the station electrical system. The major components of the station electrical system are determined under the general principles of § 263(a).

.21 *Safety system*. (1) A power station's safety equipment constitutes a single unit of property. The safety system is the equipment that alerts generation plant personnel to potentially hazardous conditions (including sirens, alarms, and evacuation systems).

(2) No special rule is provided under this revenue procedure for the major components of the safety system. The major components of the safety system are determined under the general principles of § 263(a).

.22 *Fire protection system*. (1) A power station's fire protection system constitutes a single unit of property. The fire protection system is the equipment that detects, suppresses and extinguishes fires.

(2) No special rule is provided under this revenue procedure for the major components of the fire protection system. The major components of the fire protection system are determined under the general principles of § 263(a).

.23 *Combustion turbine*. (1) Each combustion turbine constitutes a single unit of property. The combustion turbine is the equipment that draws in air, compresses it, mixes it with fuel, ignites it to produce hot gases, and converts the energy into a rotary motion, which motion is used to power the generator.

(2) The combustion turbine contains the following major components:

(a) compressor section,

(b) combustor section,

(c) drive section,

(d) shaft,

(e) shell and casing, and

(f) instrumentation and controls.

.24 *Heat recovery steam generator*. (1) Each heat recovery steam generator is a unit of property. The heat recovery steam generator is the equipment that uses heat exhaust from a combustion turbine and produces steam that can be used on a steam turbine. A heat recovery steam generator is used in a combined-cycle power station.

(2) The heat recovery steam generator has six major components:

(a) ductwork, including the combustion air ductwork, the flue gas ductwork, and all related expansion joints,

(b) deaerator,

(c) economizer,

(d) evaporator,

(e) superheater, and

(f) instrumentation and controls.

.25 *Accessory buildings*. (1) Each accessory building constitutes a single unit of property. An accessory building is a building located at a power plant that is not station property as defined in subsection 3.02 above. For example, laboratory buildings, training buildings, warehouses, administrative buildings, pre-admittance buildings, and maintenance shops are accessory buildings.

(2) No special rule is provided under this revenue procedure for the major components of the accessory buildings. The major components or substantial structural parts of an accessory building are determined under the general principles of § 263(a).

SECTION 4. UNITS OF PROPERTY FOR HYDROELECTRIC POWER STATIONS

.01 *In general*. For hydroelectric power stations, the Service will not challenge any of the following unit of property or major component determinations for purposes of the application of § 263(a) and the regulations thereunder.

.02 *Station Property*. (1) Station property serving a hydroelectric generating unit constitutes a single unit of property. Station property is each structure that physically supports and/or encloses the generating unit equipment, and associated systems and support facilities. It does not include accessory buildings (such as administrative, training, or laboratory buildings) or administrative office sections of the power station and systems that support administrative space (such as heating, air conditioning and ventilation, plumbing, and the electrical system within the administrative space). As noted in Appendix A, section 1.01 above, if a unit of property is shared by more than one generating unit, the unit of property is a single unit of property. However, in a power station with two generating units, if a single structure and its associated systems solely supports generating unit 1, another structure and its associated systems solely supports generating unit 2, and a third structure and its associated systems supports both generating units 1 and 2, there are three separate units of station property (the structure and its associated systems solely supporting generating unit 1, the structure and its associated systems solely supporting generating unit 2, and the structure and its associated systems supporting both generating units 1 and 2).

(2) Station property contains the following major components:

(a) turbine room crane,

(b) all other overhead cranes, and

(c) all compressed air systems.

.03 *Dam*. (1) Each dam constitutes a single unit of property. The dam is the equipment that forms a barrier that impounds water and manages its flow.

(2) The dam contains the following major components:

(a) spillway,

(b) each spillway gate,

(c) intakes, including trash racks and rakes,

(d) fish passage system (*e.g.*, fish ladders, elevators, and similar items), and

(e) instrumentation and controls.

.04 *Water control system*. (1) Each water control system constitutes an individual unit of property. The water control system is the equipment that controls the flow of water through the dam and to a water turbine. Within the water control system, a penstock carries

water from a starting point, such as a reservoir intake, to a subsequent location, such as a turbine or a point of branching to multiple turbines or other penstocks. If the latter point is a branch, then that is the point of beginning of another penstock.

(2) The water control system contains the following major components:

(a) each penstock, including tunnels, flumes, and canals,

(b) each primary shut-off gate,

(c) surge shafts, tanks, and chambers associated with each penstock,

(d) navigation locks, and

(e) instrumentation and controls.

.05 *Water turbine*. (1) Each water turbine constitutes an individual unit of property. The water turbine is the equipment that converts the kinetic energy of moving water into a rotary motion, which motion is used to power the generator.

(2) The water turbine contains the following major components:

(a) nozzles,

(b) each complete water wheel or runner,

(c) turbine shaft,

(d) turbine shell and casing,

(e) each wicket gate set, and

(f) instrumentation and control.

.06 *Generator*. (1) Each generator constitutes a single unit of property. The generator is the equipment that converts the mechanical energy produced by the water turbine to electrical energy.

(2) The generator contains the following major components:

(a) stator, including the windings, shell, and casing,

(b) rotor, including core and windings, and

(c) instrumentation and controls.

.07 *Water treatment system (e.g., at pumped storage facility)*. (1) Each water treatment system constitutes a single unit of property. The water treatment system is generally the equipment that removes minerals and other impurities in the water to produce higher purity water for industrial cooling, which, if present, is used for cooling the turbines and generators.

(2) The water treatment system contains the following major components:

(a) filtration system,

(b) demineralization system, and

(c) instrumentation and controls.

.08 *Cooling and utility water system*. (1) Each cooling and utility water system constitutes a single unit of property. The cooling and utility water system is the equipment that supplies cooling water or utility water to a generating unit.

(2) The cooling and utility water system contains the following major components:

(a) tanks,

(b) piping system, and

(c) instrumentation and controls.

.09 *Auxiliary power system*. (1) Each auxiliary power system constitutes a single unit of property. The auxiliary power system is the equipment that provides back-up electrical power for the generation plant.

(2) The auxiliary power system contains one major component: each auxiliary generator.

.10 *Main step-up transformer*. (1) Each main step-up transformer constitutes a single unit of property. The main step-up transformer is equipment that increases the voltage of the electricity generated at the generation plant to a voltage level needed for the transmission of the electricity.

(2) The main step-up transformer has no major components.

.11 *Ventilation System*. (1) Each ventilation system serving a unit of station property, as defined in subsection 4.02 above, constitutes a single unit of property. The ventilation system is the equipment that circulates and filters the air in the station property.

(2) No special rule is provided under this revenue procedure for the major components of the ventilation system. The major components of the ventilation system are determined under the general principles of § 263(a).

.12 *Station electrical delivery system*. (1) A power station's electrical delivery system constitutes a single unit of property. The station electrical delivery system is the equipment that distributes electrical power in the power plant.

(2) No special rule is provided under this revenue procedure for the major components of the station electrical system. The major components of the station electrical system are determined under the general principles of § 263(a).

.13 *Safety system*. (1) A power station's safety equipment constitutes a single unit of property. The safety system is the equipment that alerts generation plant personnel to potentially hazardous conditions (including sirens, alarms, and evacuation systems).

(2) No special rule is provided under this revenue procedure for the major components of the safety system. The major components of the safety system are determined under the general principles of § 263(a).

.14 *Fire Protection System*. (1) A power station's fire protection system constitutes a single unit of property. The fire protection system is the equipment that detects, suppresses, and extinguishes fires.

(2) No special rule is provided under this revenue procedure for the major components of the fire protection system. The major components of the fire protection system are determined under the general principles of § 263(a).

.15 *Accessory Buildings*. (1) Each accessory building constitutes a single unit of property. An accessory building is a building located at a hydroelectric power plant that is not station property. For example, laboratory buildings, training buildings, warehouses, administrative buildings, pre-admittance buildings, and maintenance shops are accessory buildings.

(2) No special rule is provided under this revenue procedure for the major components of the accessory buildings, The major components or substantial structural parts of an accessory building are determined under the general principles of § 263(a).

SECTION 5. UNITS OF PROPERTY FOR NUCLEAR-POWERED POWER STATIONS

.01 *In general*. A nuclear-powered power station uses either a boiling water reactor (BWR) or a pressurized water reactor (PWR) to generate steam, but not both. Therefore, an individual nuclear-powered power station will not contain all of the units of property or major components listed below. For nuclear-powered power stations, the Service will not challenge any of the following unit of property or major component determinations for purposes of the application of § 263(a) and the regulations thereunder.

.02 *Station property*. (1) Station property serving a generating unit constitutes a single unit of property. Station property is each structure that physically supports and/or encloses the generating unit equipment, and associated systems and support facilities. It does not include accessory buildings (such as administrative, training, or laboratory buildings) or administrative office sections of the power station and systems that support administrative space (such as heating, air conditioning and ventilation, plumbing, and the electrical system within the administrative space). As noted in Appendix A, section 1.01 above, if a unit of property is shared by more than one generating unit, the unit of property is a single unit of property. However, in a power station with two generating units, if a single structure and its associated systems solely supports generating unit 1, another structure and its associated systems solely supports generating unit 2, and a third structure and its associated systems supports both generating units 1 and 2, there are three separate units of station property (the structure and its associated systems solely supporting generating unit 1, the structure and its associated systems solely supporting generating unit 2, and the structure and its associated systems supporting both generating units 1 and 2).

(2) Station property contains the following major components:

(a) turbine building crane,

(b) reactor building crane,

(c) all other overhead cranes, and

(d) all compressed air systems.

.03 *Containment Building*. (1) Each containment building constitutes a single unit of property. The containment building is the structure enclosing a nuclear reactor.

(2) The containment building contains one major component: the containment building access doors.

.04 *Reactor emergency poison system*. (1) Each emergency poison system for an individual reactor constitutes a single unit of property. The reactor emergency poison system is the equipment used to inject soluble neutron poison into the reactor coolant in the event of an emergency to terminate the heat generating nuclear reaction.

(2) The reactor emergency poison system contains the following major components:

(a) storage tank, and

(b) injection equipment.

.05 *Reactor vessel*. (1) Each reactor vessel constitutes a single unit of property. The reactor vessel is the pressurized vessel containing the reactor coolant and the reactor core where the heat produced by nuclear fission is transferred to water in a process that creates steam.

(2) The reactor vessel contains the following major components:

(a) reactor vessel head,

(b) steam separator (BWR),

(c) steam dryer (BWR),

(d) reactor core plate assembly, and

(e) instrumentation and controls.

.06 *Nuclear fuel system*. (1) Each nuclear fuel system constitutes a single unit of property. The nuclear fuel system is the equipment that monitors and controls the nuclear fuel in a reactor vessel.

(2) The nuclear fuel system contains one major component: instrumentation and controls.

.07 *Reactor recirculation system (BWR)*. (1) Each reactor recirculation system constitutes a single unit of property. The reactor recirculation system is the equipment in a boiling water reactor that returns condensed water to the reactor core to be heated into steam.

(2) The reactor recirculation system contains the following major components:

(a) each recirculating pump,

(b) each jet pump, and

(c) instrumentation and controls.

.08 *Reactor coolant system (PWR).* (1) Each reactor coolant system constitutes a single unit of property. The reactor coolant system is the equipment in a pressurized water reactor that circulates liquid coolant through the reactor core, the pressurizer, and the steam generator.

(2) The reactor coolant system contains the following major components:

(a) each steam generator,

(b) pressurizer,

(c) each reactor cooling water pump,

(d) each loop of the water conveyance system,

(e) each safety injection tank, and

(f) instrumentation and controls.

.09 *Feed and steam cycle.* (1) Each feed and steam cycle serving an individual reactor constitutes a single unit of property. The feed and steam cycle is the equipment that forms a closed loop through which the treated water circulates from the condenser to the reactor or steam generator, through the turbines, and back to the condenser.

(2) The feed and steam cycle contains the following major components, the number of which will vary depending on the reactor technology used:

(a) each reactor feed pump (BWR),

(b) each feedwater pump (PWR),

(c) each loop of the water conveyance system,

(d) each condenser,

(e) each condensate pump,

(f) each demineralizer,

(g) each heat exchanger or feedwater heater,

(h) each moisture separator, and

(i) instrumentation and controls.

.10 *Cooling water system.* (1) Each cooling water system constitutes a single unit of property. The cooling water system is the equipment that removes heat from the feed and steam cycle. The removal of heat is accomplished by bringing in water from an outside source and using a cooling tower or other cooling device to remove heat.

(2) The cooling water system contains the following major components:

(a) each cooling water pump,

(b) each cooling tower,

(c) each loop of the water conveyance system,

(d) screens, and

(e) instrumentation and controls.

.11 *High pressure core safety system (BWR).* (1) Each high pressure core safety system constitutes a single unit of property. The high pressure core safety system is the equipment that injects pressurized coolant into a boiling water reactor vessel in the event of an emergency.

(2) The high pressure core safety system contains the following major components:

(a) each tank,

(b) each high pressure core injection pump,

(c) each loop of the water conveyance system, and

(d) instrumentation and controls.

.12 *Automatic depressurization system (BWR).* (1) Each automatic depressurization system constitutes a single unit of property. The automatic depressurization system is the equipment that depressurizes a boiling water reactor vessel and allows lower pressure coolant injection systems to function.

(2) The automatic depressurization system contains the following major components:

(a) each loop of the water conveyance system, and

(b) instrumentation and controls.

.13 *Low pressure coolant injection system (BWR).* (1) Each low pressure coolant injection system constitutes a single unit of property. The low pressure coolant injection system is the equipment that injects coolant into a depressurized boiling water reactor vessel in the event of an emergency. This unit of property may not be in place where a low pressure core spray system is used.

(2) The low pressure injection system contains the following major components:

(a) each residual heat removal exchanger,

(b) each low pressure coolant injection pump,

(c) each tank,

(d) each loop of the water conveyance system, and

(e) instrumentation and controls.

.14 *Low pressure core spray system (BWR)*. (1) Each low pressure core spray system constitutes a single unit of property. The low pressure core spray system is the equipment that sprays water onto the nuclear fuel in a depressurized boiling water reactor vessel in the event of an emergency. This unit of property may not be in place where a low pressure coolant injection system is used.

(2) The low pressure core spray system contains the following major components:

(a) each low pressure core spray pump,

(b) each tank,

(c) each loop of the water conveyance system, and

(d) instrumentation and controls.

.15 *Core flood system (PWR)*. (1) Each core flood system constitutes a single unit of property. The core flood system is the equipment used to flood the reactor vessel in a pressurized water reactor in the event of an emergency.

(2) The core flood system contains the following major components:

(a) each core flood tank,

(b) each loop of the water conveyance system, and

(c) instrumentation and controls.

.16 *Turbine*. (1) Each turbine constitutes a single unit of property. The turbine is the equipment that extracts thermal power from pressurized steam and converts the energy into a rotary motion, which motion is used to power the generator.

(2) The turbine contains the following major components:

(a) complete set of turbine high-pressure section blades,

(b) complete set of turbine mid-pressure section blades,

(c) complete set of turbine low-pressure section blades,

(d) shaft section in each section of the turbine (*i.e.*, since the turbine has high, medium, and low-pressure sections, there are three major components: one shaft for each section of the turbine),

(e) shell and casing, and

(f) instrumentation and controls.

.17 *Generator*. (1) Each generator constitutes a single unit of property. The generator is the equipment that converts the mechanical energy produced by the water turbine to electrical energy.

(2) The generator contains the following major components:

(a) stator, including the windings, shell, and casing,

(b) rotor, including core and windings, and

(c) instrumentation and controls.

.18 *Water treatment system*. (1) Each water treatment system constitutes a single unit of property. The water treatment system is generally the equipment that removes minerals and other impurities in the water, which is used in the reactor vessel, the reactor recirculation system (BWR), the reactor coolant system (PWR), the feed and steam cycle, the cooling water system, the high pressure core safety system (BWR), the automatic depressurization system (BWR), the low pressure coolant injection system (BWR), the low pressure core spray system (BWR), and the core flood system (PWR).

(2) The water treatment system contains the following major components:

(a) filtration system,

(b) desalinization system,

(c) evaporator,

(d) demineralization system,

(e) disinfection system,

(f) sedimentation system, and

(g) instrumentation and controls.

.19 *Water supply system*. (1) Each water supply system constitutes a single unit of property. The water supply system is the equipment that supplies water to the generation plant.

(2) The water supply system contains the following major components:

(a) each storage tank,

(b) water conveyance system, and

(c) instrumentation and controls.

.20 *Wastewater system*. (1) Each wastewater system constitutes a single unit of property. A wastewater system that integrates multiple treatment processes into one system is a single unit of property. Wholly separate and discrete wastewater systems are treated as separate units of property. The wastewater system is the equipment that treats and disposes of wastewater.

(2) The wastewater system contains the following major components:

(a) each treatment tank,

(b) wastewater conveyance system, and

(c) instrumentation and controls.

.21 *Radioactive liquid treatment and disposal system*. (1) Each radioactive liquid treatment and disposal system constitutes a single unit of property. The radioactive liquid treatment and disposal system is the equipment that decontaminates liquid radioactive waste prior to the release or recycling of the decontaminated liquid.

(2) The radioactive liquid treatment and disposal system contains the following major components:

(a) each tank,

(b) liquid conveyance system,

(c) liquid concentrator, and

(d) instrumentation and controls.

.22 *Radioactive gas treatment and disposal system*. (1) Each radioactive gas treatment and disposal system constitutes a single unit of property. The radioactive gas treatment and disposal system is the equipment that decontaminates gaseous radioactive waste prior to the release of the decontaminated gas.

(2) The radioactive gas treatment and disposal system contains the following major components:

(a) each tank,

(b) gas conveyance system,

(c) condenser,

(d) each stack, and

(e) instrumentation and controls.

.23 *Radioactive solid treatment and disposal system*. (1) Each radioactive solid treatment and disposal system constitutes a single unit of property. The radioactive solid treatment and disposal system is the equipment that compacts or incinerates radioactive solids prior to storage or disposal.

(2) The radioactive solid treatment and disposal system contains one major component: the instrumentation and controls.

.24 *Fuel storage and handling system*. (1) Each fuel storage and handling system constitutes a single unit of property. The fuel storage and handling system is the equipment that receives fresh nuclear fuel, stores fresh fuel, delivers it to the reactor, removes spent fuel from the reactor, and stores the spent fuel prior to dry cask storage.

(2) The fuel storage and handling system contains the following major components:

(a) fuel pool,

(b) fuel storage rack system,

(c) fuel cranes, and

(d) instrumentation and controls.

.25 *Dry cask facility*. (1) Each dry cask facility constitutes a single unit of property. The dry cask facility is the equipment that temporarily stores spent nuclear fuel, where applicable.

(2) The dry cask facility contains the following major components:

(a) each spent fuel cask prior to being filled,

(b) each dry cask transfer vehicle, and

(c) instrumentation and controls.

.26 *Auxiliary power system*. (1) Each auxiliary power system constitutes a single unit of property. The auxiliary power system is the equipment that provides back-up electrical power for the generation plant, which is needed to restart the generating unit after a shutdown.

(2) The auxiliary power system contains one major component: each auxiliary generator.

.27 *Simulator*. (1) Each simulator constitutes a single unit of property. The simulator is the equipment that is used to train plant personnel in the operations (including safety and rescue) of the power plant.

(2) The simulator has no major components.

.28 *Main step-up transformer*. (1) Each main step-up transformer constitutes a single unit of property. The main step-up transformer is equipment that increases the voltage of the electricity generated at the generation plant to a voltage level needed for the transmission of the electricity.

(2) The main step-up transformer has no major components.

.29 *Heating, ventilation, and air conditioning (HVAC) system*. (1) Each heating, ventilation, and air conditioning (HVAC) system serving a unit of station property, as defined in subsection 5.02 above, constitutes a single unit of property. The HVAC system is the equipment that conditions, circulates, and filters the air in the station property.

(2) No special rule is provided under this revenue procedure for the major components of the station electrical system. The major components of the HVAC system are determined under the general principles of § 263(a).

.30 *Station electrical delivery system*. (1) A power station's electrical delivery system constitutes a single unit of property. The station electrical delivery system is the equipment that distributes electrical power in the power plant.

(2) No special rule is provided under this revenue procedure for the major components of the station electrical system. The major components of the station electrical system are determined under the general principles of § 263(a).

.31 *Safety system*. (1) A power station's safety system constitutes a single unit of property. The safety system is the equipment that alerts power plant personnel to potentially hazardous conditions (including sirens, alarms, and evacuation systems).

(2) The safety system contains the following major components:

(a) emergency evacuation system, and

(b) radiological hygiene station.

.32 *Environmental radiation monitoring system*. (1) A power station's environmental radiation monitoring system constitutes a single unit of property. The environmental radiation monitoring system is the equipment that continuously monitors the environmental radiation levels inside and outside the generation plant.

(2) The environmental radiation monitoring system contains the following major components:

(a) the water monitoring system, and

(b) the air monitoring system.

.33 *Security system*. (1) The security system at a power plant constitutes a single unit of property. The security system is the equipment used to provide security at the generation plant.

(2) The security system contains the following major components:

(a) the explosive detection system, and

(b) each guard tower.

.34 *Fire Protection System*. (1) A power station's fire protection system constitutes a single unit of property. The fire protection system is the equipment that detects, suppresses, and extinguishes fires.

(2) No special rule is provided under this revenue procedure for the major components of the fire protection system. The major components of the fire protection system are determined under the general principles of § 263(a).

.35 *Accessory Buildings*. (1) Each accessory building constitutes a single unit of property. An accessory building is a building located at a nuclear-powered power station that is not station property as defined in subsection 5.02 above. For example, laboratory buildings, training buildings, warehouses, administrative buildings, pre-admittance buildings, and maintenance shops are accessory buildings.

(2) No special rule is provided under this revenue procedure for the major components of the accessory buildings. The major components or substantial structural parts of an accessory building are determined under the general principles of § 263(a).

APPENDIX B

Extrapolation Guidance

SECTION 1. INTRODUCTION

.01 *In general*. This appendix provides an extrapolation methodology an eligible taxpayer may use in connection with a change in method of accounting to use the unit of property and major component definitions provided by this revenue procedure. The extrapolation methodology described in this Appendix B provides the exclusive extrapolation methodology that is permitted under the method of accounting provided in this revenue procedure for determining the amount of a § 481(a) adjustment.

.02 *Scope.* This revenue procedure, including this Appendix B, does not apply to property for which a taxpayer does not use a unit of property determination provided in Appendix A to this revenue procedure.

SECTION 2. EXTRAPOLATION METHODOLOGY

.01 *In general*. A taxpayer making a change to apply the method of accounting provided by this revenue procedure may use the extrapolation procedures provided in this Appendix B to determine the § 481(a) adjustment resulting from the change in method of accounting. Generally, the taxpayer first applies the method to a testing period of recent, representative years, and derives an average repair deduction under the method of accounting, as a percentage of total capital additions (for financial accounting purposes). This percentage, adjusted by a reduction percentage that varies based on time, is then applied to the adjusted capital additions (for financial accounting purposes) for prior years for which extrapolation is used to derive a deemed § 481(a) adjustment amount for each year. These extrapolated § 481(a) adjustment amounts are then combined with the actual adjustment amounts for years in which the § 481(a) adjustment is calculated in the normal manner to arrive at the total § 481(a) adjustment attributable to the change in method of accounting.

.02 *Calculation methodology*. In order to determine the amount of the § 481(a) adjustment when extrapolation is applied, the following calculation methodology must be used:

(1) *Testing period*. First, a testing period is determined as follows:

(a) *In general*. The taxpayer must use as the testing period a minimum of three consecutive taxable years ("testing years"), except as described in paragraph 2.02(1)(b)(ii) of this Appendix B. Generally, the final year of the testing period is the taxable year preceding the year of change. Alternatively, a taxpayer may choose the year of change as the final year of the testing period.

(b) *Representative years required*. The testing years must be representative of all years included in the § 481(a) adjustment.

(i) In determining whether a year is representative, a taxpayer must take into account restructuring transactions, including acquisitions and dispositions, as well as any other events, that may have triggered large capital additions.

(ii) If one of the taxable years in the testing period described in section 2.02(1)(a) of this Appendix B is not representative, the taxpayer must exclude data from the non-representative year from the testing period and use data from the fourth most recent taxable year to establish a testing period (with such fourth most recent taxable year being a testing year). If the fourth most recent taxable year is not representative either, the taxpayer must consult with its examining agent or team to determine whether extrapolation is appropriate in the taxpayer's situation.

(c) *Additional years*. Under the extrapolation calculation methodology, if the taxpayer has sufficient data to calculate the repair deduction percentage for more than three years, the taxpayer may include those years in the testing period. The additional testing years must be consecutive years that immediately precede the original three-year testing period, except that a year that is not representative, as described in section 2.02(1)(b) of this Appendix B, should be excluded. A taxpayer may not use, as an additional testing year, a year that is separated from the rest of the testing period by more than one non-representative year.

(2) *Repair deduction percentage*. Second, a repair deduction percentage for each year for which extrapolation is used ("extrapolation year") is computed as follows, using data from the testing period.

(a) *Repair deductions during the testing period under the proposed method*. For each testing year, the amount of repair expenses that would be deductible under the method of accounting provided in this revenue procedure, before taking into account book-tax basis adjustments, is determined.

(b) *Tentative repair deduction percentage*. The sum of the deductible repair expenses for all testing years in the testing period, as determined under section 2.02(2)(a) of this Appendix B, is then divided by the sum of all capital additions during the testing period. For this purpose, a taxpayer must use capital additions for financial statement purposes ("book capital additions"). The resulting ratio represents the average percentage of capitalized additions that are properly treated as deductible repair expenses under the taxpayer's proposed method of accounting ("tentative repair deduction percentage"), before taking into account book-tax basis adjustments.

(c) *Repair deduction percentage for an extrapolation year*. The tentative repair deduction percentage is then multiplied by a reduction percentage for each extrapolation year. For each extrapolation year, the reduction percentage is determined by using the formula (1- (0.10*(*X*/*Y*))), where *X* equals the number of years the extrapolation year precedes the final year of the testing period and *Y* equals the total of number of taxable years in the testing period. The reduction percentage for an extrapolation year multiplied by the tentative repair deduction percentage equals the repair deduction percentage for the extrapolation year.

(3) *Extrapolation year tentative repair deduction amount*. Third, a tentative repair deduction amount under the proposed method is calculated for each extrapolation year.

(a) The repair deduction amount for an extrapolation year is calculated by multiplying the repair deduction percentage for the extrapolation year (determined in section 2.02(2) of this Appendix B) by the book capital additions for the extrapolation year.

(b) In determining the repair deduction amount for an extrapolation year, a taxpayer must account for any book-tax basis adjustments for property placed in service in the extrapolation year. Book-tax basis adjustments for property placed in service in the extrapolation year may be accounted for by multiplying the tentative repair deduction amount for an extrapolation year by the taxpayer's book-to-tax adjustment percentage for the extrapolation year. Tax adjustments that must be accounted for include, among other things, the following types of adjustments:

(i) adjustments resulting from a change in method of accounting permitted under Rev. Rul. 2000–7, 2000–1 C.B. 712, involving the treatment of the costs incurred in removing retired assets;

(ii) adjustments resulting from a change in the treatment of capitalized amounts determined under § 263A, including reductions for additional mixed service costs allocated to inventory and adjustments to account for changes to interest capitalization amounts;

(iii) adjustments arising from casualty loss deductions recognized under § 165; and

(iv) adjustments resulting from research and experimental expenditures deducted under § 174.

(4) *Repair allowance adjustment and repair deduction amount*. Fourth, for each extrapolation year in which the repair allowance election under § 1.167(a)–11(d)(2) (ADR repair allowance) was made, the tentative repair deduction amount must be reduced by the cost of repairs to generation property attributable to ADR repair allowance property. To determine the reduction where a prior ADR repair allowance election was made for generation property, taxpayers must use a method comparable to the method actually used to allocate qualified repair expenditures to repair allowance property for that year. For example, if in applying § 1.167(a)–11(d)(2) for the 1997 taxable year a taxpayer determined that 73 percent of its 1997 qualified repair expenditures for generation property were attributable to repair allowance property, then that same percentage (73%) must be applied to determine the reduction to the repair deduction amount otherwise calculated under section 2.02(3) of this Appendix B. The amount determined after reducing the tentative repair deduction amount by the cost of repairs attributable to ADR repair allowance property is the repair deduction amount for the extrapolation year.

(5) *Tentative § 481(a) adjustment amount*. Fifth, the tentative § 481(a) adjustment amount for each extrapolation year is determined. The tentative § 481(a) adjustment amount for each extrapolation year is calculated by subtracting the repair deduction amount for the extrapolation year, as determined in sections 2.02(1) through 2.02(4) of this Appendix B, from the amount of repair expenses the taxpayer deducted for that year under its prior method of accounting (including § 481(a) adjustments resulting from any prior method change). The difference, whether positive or negative, is the tentative § 481(a) adjustment amount for the extrapolation year.

(6) *Extrapolation year § 481(a) adjustment amount*. Sixth, the tentative § 481(a) adjustment amount for each extrapolation year must be adjusted to account for any differences in depreciation, credits, or any other cumulative differences in deductions between the extrapolation year and the year of change resulting from the taxpayer's proposed method of accounting. For instance, if under the proposed method a taxpayer's repair deduction for an extrapolation year would be tentatively increased by $1,000, such that the unadjusted basis of the property placed in service would be correspondingly decreased by $1,000, the $1,000 tentative repair deduction increase for the extrapolation year must be reduced by the portion of the $1,000 in unadjusted basis that the taxpayer had recovered prior to the year of change.

(7) *Total § 481(a) adjustment*. Finally, the total § 481(a) adjustment attributable to the change to the taxpayer's proposed method of accounting is determined. The total § 481(a) adjustment for the year of change is calculated by combining the § 481(a) adjustment amounts for all extrapolation years, as described in this section 2.02, with the adjustment amounts, after taking into account book-tax basis adjustments, for years determined under § 481(a) in the normal manner.

.03 *Example*. In 2012, W, a calendar year taxpayer, changes its method of accounting for all of W's electric generation property to use the unit of property and major component definitions provided in Appendix A of this revenue procedure. W uses the extrapolation methodology provided in section 2 of this Appendix B to determine the amount of its § 481(a) adjustment attributable to taxable years 1992 through 2008.

Following the general rule in section 2.02(1) of this Appendix B, W uses as its testing period 2009, 2010, and 2011, the three consecutive taxable years ending with 2011, the year preceding the year of change. Assume that each of 2009, 2010, and 2011 are representative of all years included in W's § 481(a) adjustment.

W's book capital additions for 2009, 2010, and 2011 are $3,000, $3,000, and $4,000, respectively, for a total of $10,000. Of these amounts, the portions that are properly treated as deductible repair expenses resulting from the application of W's proposed method of accounting for 2009, 2010, and 2011, before taking into account book-tax basis adjustments, are $300, $400, and $300, respectively, for a total of $1,000.

For 2003, W's book capital additions are $3,333. W's book-to-tax adjustment percentage for 2003 is 90%. In 2003, W elected to apply the ADR repair allowance under § 1.167(a)–11(d)(2), which applied to 25% of W's generation property. Under W's prior method of accounting (prior to application of the method of accounting provided by this revenue procedure), W deducted $150 in repair expenses in 2003.

W determines its section 481(a) adjustment for 2003 as follows:

Step 1. W determines that it will use taxable years 2009, 2010, and 2011 as the testing years in its testing period.

Step 2. W calculates its repair deduction percentage for 2003. First, a tentative repair deduction percentage is calculated using data from the testing period (taxable years 2009, 2010, and 2011). Book capital additions that are properly treated as deductible repair expenses resulting from the application of the proposed method of accounting, before taking into account book-tax basis adjusments, for 2009, 2010, and 2011, the testing years that comprise the testing period, equal $1,000 ($300 + $400 + $300). Total book capital additions for the testing period are $10,000 ($3,000 + $3,000 + $4,000). W's tentative repair deduction percentage is 10% ($1,000 / $10,000).

Next, W calculates the reduction percentage for each extrapolation year using the formula (1 - 0.10 * (*X*/*Y*)), where *X* equals the number of years the extrapolation year precedes 2011, the final year of the testing period, and *Y* equals 3, the number of years in the testing period. The reduction percentage for each extrapolation year is calculated as follows:

Taxable Year	*Reduction Percentage Calculation (Step A)*	*Reduction Percentage Calculation (Step B)*
2008	0.10 * (3/3) = 0.10	1 - 0.10 = 0.90 = 90.0%
2007	0.10 * (4/3) = 0.133	1 - 0.133 = 0.867 = 86.7%
2006	0.10 * (5/3) = 0.167	1 - 0.167 = 0.833 = 83.3%
2005	0.10 * (6/3) = 0.20	1 - 0.20 = 0.80 = 80.0%
2004	0.10 * (7/3) = 0.233	1 - 0.233 = 0.767 = 76.7%
2003	0.10 * (8/3) = 0.267	1 - 0.267 = 0.733 = 73.3%
2002	0.10 * (9/3) = 0.30	1 - 0.30 = 0.70 = 70.0%
2001	0.10 * (10/3) = .333	1 - 0.333 = 0.667 = 66.7%
2000	0.10 * (11/3) = .367	1 - 0.367 = 0.633 = 63.3%
1999	0.10 * (12/3) = .40	1 - 0.40 = 0.60 = 60.0%
1998	0.10 * (13/3) = .433	1 - 0.433 = 0.567 = 56.7%
1997	0.10 * (14/3) = .467	1 - 0.467 = 0.533 = 53.3%
1996	0.10 * (15/3) = .50	1 - .50 = 0.50 = 50.0%
1995	0.10 * (16/3) = .533	1 - 0.533 = 0.467 = 46.7%
1994	0.10 * (17/3) = .567	1 - 0.567 = 0.433 = 43.3%
1993	0.10 * (18/3) = .60	1 - 0.60 = 0.40 = 40.0%
1992	0.10 * (19/3) = .633	1 - 0.633 = 0.367 = 36.7%

Finally, W's calculates the repair deduction percentage for 2003 (7.33%) by multiplying the tentative repair deduction percentage (10%) by the reduction percentage for 2003 (73.3%).

Step 3. W calculates a tentative repair deduction amount for 2003. First W multiplies its book capital additions for 2003 ($3,333) by its repair deduction percentage (7.33%), resulting in an initital tentative repair deduction amount of $244. Next, W accounts for any book-tax basis adjustments for property placed in service in 2003 by multiplying the initial tentative repair deduction amount ($244) for 2003 by the taxpayer's book-to-tax adjustment percentage for 2003 (90%), resulting in a tentative repair deduction amount of $220.

Step 4. W must reduce its tentative repair deduction amount for 2003 to exclude repairs attributable to generation property for which the taxpayer elected to apply the ADR repair allowance. In 2003, W determined that 25 percent of its 2003 qualified repair expenditures for generation property were attributable to repair allowance property. Therefore, W reduces the repair deduction amount for 2003 ($220) by 25% ($55), yielding a repair deduction amount for 2003 of $165.

Step 5. W determines its tentative § 481(a) adjustment amount for 2003. W subtracts the adjusted gross repair deduction amount for 2003 ($165) from the amount of repair expenses W deducted for 2003 under its prior method of accounting (as adjusted for purposes of computing any prior § 481(a) adjustment) ($150). Therefore, W's § 481(a) adjustment amount for 2003 is negative $15.

Step 6. To determine its § 481(a) adjustment amount for 2003, W must account for its decreased depreciation deductions resulting from the additional $15 of deductible repair expenditures permitted under the proposed method of accounting. Assuming that the additional $15.00 of deductible repair expenditures for 2003 results in a $4.50 of reduction in cumulative depreciation expense through the year of change that is attributable to the assets placed in service in 2003, W's § 481(a) adjustment amount for the increased repair deductions that would have been permitted in 2003 under the proposed method of accounting is negative $10.50 (-$15.00 + $4.50).

Step 7. To determine its total § 481(a) adjustment, W combines the adjustments attributable to 1992 through 2008, computed using the extrapolation method in this Appendix B (as described above for 2003), with the § 481(a) adjustments attributable to 2009 through 2011, determined using the actual data from those years and taking into account book-tax basis adjustments. W must take the entire § 481(a) adjustment (whether positive or negative) into account in 2012, W's year of change.

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26 CFR 601.601: Rules and regulations.
(Also Part I, § 1272(a)(6))

Rev. Proc. 2013–26

SECTION 1. PURPOSE

This revenue procedure allows a taxpayer to use a safe harbor method of accounting for original issue discount ("OID") on a pool of credit card receivables for purposes of § 1272(a)(6) of the Internal Revenue Code ("Code")—the "proportional method." The proportional method generally allocates to an accrual period an amount of unaccrued OID that is proportional to the amount of the stated redemption price at maturity ("principal") of the pool that is paid by cardholders during the period. The proportional method described in this revenue procedure generally produces the same results as the method described in § 1272(a)(6). The revenue procedure also describes the exclusive procedures by which a taxpayer may obtain the Commissioner's consent to change to the proportional method.

Notice 2011–99, 2011–50 I.R.B. 847 (Dec. 12, 2011), contained a proposed revenue procedure that described the proportional method of accounting. Notice 2011–99 invited public comments regard-

ing the proposed revenue procedure. The Department of the Treasury and the Internal Revenue Service ("IRS") considered all comments received, and modified the proposed revenue procedure in response to the comments. The significant changes in this revenue procedure from the proposed revenue procedure are as follows:

(1) The revenue procedure applies to any taxpayer that holds a pool of credit card receivables and is not limited to credit card issuers;

(2) A taxpayer may use the proportional method for amounts treated by the revenue procedure as OID (for example, amounts that otherwise are market discount);

(3) When individual accounts are transferred out of a pool or written off, a taxpayer may attribute to those accounts a portion of a pool's unaccrued OID that is proportional to their outstanding balances; and

(4) A taxpayer may adopt the proportional method, or change to the proportional method under the automatic consent procedures, for a taxable year that ends on or after December 31, 2012.

SECTION 2. BACKGROUND

.01 A debt instrument is issued with OID if the instrument's issue price is less than its stated redemption price at maturity ("SRPM"). Section 1273(a)(1). Under § 1.1273–1(b) of the Income Tax Regulations, the SRPM of a debt instrument is the sum of all payments provided by the debt instrument other than payments of qualified stated interest. In general, qualified stated interest is stated interest that is unconditionally payable in cash, or that is constructively received under § 451, at least annually at a single fixed rate. Section 1.1273–1(c).

.02 Accruals of OID generally are taken into account over the term of a debt instrument using the constant yield method. See § 1272(a)(3) and § 1.1272–1. The Code provides special rules, however, for certain debt instruments for which the principal is subject to acceleration. See § 1272(a)(6). Under § 1272(a)(6), OID accruals are determined based on a prepayment assumption and a formula involving the present value of all remaining payments under the debt instrument as of the close of the accrual period, payments during the accrual period of amounts included in the SRPM of the debt instrument, and the adjusted issue price of the debt instrument at the beginning of the accrual period ("statutory method").

.03 The Taxpayer Relief Act of 1997 extended the rules of § 1272(a)(6) to OID on any pool of debt instruments the yield on which may be affected by reason of prepayments, including a pool of credit card receivables. See Pub. L. 105–34, § 1004(a), 1997–4 C.B. 1, 125. However, unlike the debt instruments previously subject to § 1272(a)(6), the balance of a pool of credit card receivables can be increased as well as decreased from one accrual period to the next, which adds complexity in applying the rules of § 1272(a)(6).

.04 The IRS has challenged the methods of accounting for OID on pools of credit card receivables adopted by some taxpayers as not clearly reflecting income. See, for example, *Capital One Financial Corp. v. Commissioner*, 133 T.C. 136 (2009) (holding, in relevant part, that the model used by the taxpayer for computing OID accruals under § 1272(a)(6) was a reasonable method after some modifications by the court).

.05 The proportional method of accounting described in this revenue procedure is intended to reduce administrative burdens and controversy for taxpayers and the IRS in computing OID accruals on a pool of credit card receivables under § 1272(a)(6). The proportional method is a simplified method of calculation that generally produces the same results as the statutory method.

.06 Certain credit card fees are treated as creating or increasing the amount of OID on the pool of credit card receivables to which the fees relate. See, for example, Rev. Proc. 2004–33, 2004–1 C.B. 989 (Commissioner will allow a taxpayer to treat late fees as OID). Other fees, however, do not create or increase the amount of OID on the pool of credit card receivables to which the fees relate. See, for example, Rev. Rul. 2004–52, 2004–1 C.B. 973 (credit card annual fees do not result in OID).

SECTION 3. SCOPE

This revenue procedure applies to a taxpayer if—

.01 The taxpayer holds receivables arising from credit cards that allow cardholders to access a revolving line of credit to purchase goods and services, or to obtain cash advances;

.02 For federal income tax purposes, the credit card purchase transactions of the cardholders do not create debt that is given in consideration for the sale or exchange of property;

.03 The taxpayer maintains one or more pools of receivables with respect to such credit cards (or one or more pools of receivables with respect to such credit cards are maintained on the taxpayer's behalf); and

.04 In the case of a taxpayer that maintains (or on whose behalf are maintained) more than one pool of credit card receivables, the manner in which pools are established and maintained does not achieve a result that is unreasonable in light of the purposes of §§ 1271 through 1275.

SECTION 4. APPLICATION

.01 The proportional method of accounting described in section 5 of this revenue procedure is a permissible method for use by a taxpayer within the scope of this revenue procedure to account for OID on a pool of credit card receivables described in section 3 of this revenue procedure. If the proportional method is used by a taxpayer to account for any pool of credit card receivables, the method must be used for every pool of credit card receivables described in section 3 of this revenue procedure and held by that taxpayer. If the proportional method is used for more than one such pool, separate data for each pool must be kept, and the computations must be made separately based on the data for each pool.

.02 For purposes of this revenue procedure, a taxpayer within the scope of this revenue procedure that acquires a pool of credit card receivables (or an interest in such a pool) may treat the difference between the aggregate balance (or the taxpayer's share of the balance) owed on all credit card receivables included in the pool other than amounts representing charges or fees that are not properly treated as OID (such as finance charges that are qualified stated interest) and the taxpayer's basis as OID. As a result, a taxpayer may use the proportional method for certain amounts

that would not otherwise be treated as OID, for example, market discount or bond premium.

.03 A taxpayer that wants to change its method of accounting to the proportional method must use the automatic change in method procedures of Rev. Proc. 2011–14, 2011–4 I.R.B. 330, or its successor, to make the change. See section 8 of this revenue procedure. If a taxpayer changes to the proportional method, the unaccrued OID for the pool as of the beginning of the first period in the year of change is equal to the unaccrued OID for the pool as of the end of the preceding year under the taxpayer's previous method of accounting for the pool. See section 5.02(2) of this revenue procedure. If a taxpayer does not already have a method of accounting for OID (or an amount treated as OID under section 4.02 of this revenue procedure) on any pool of credit card receivables, the taxpayer may adopt the proportional method by using it on a timely filed (including extensions) original federal income tax return for the first taxable year the taxpayer must account for OID on a pool of credit card receivables. A taxpayer may adopt or change its method of accounting to the proportional method for a taxable year that ends on or after December 31, 2012.

SECTION 5. PROPORTIONAL METHOD OF ACCOUNTING

This section 5 describes the proportional method of accounting for OID on a pool of credit card receivables. Under the method—

.01 The required computations must be made monthly. Thus, the computation period referred to below is a calendar month (or that portion of a month that falls within a short taxable year). A taxpayer that changes its method of accounting to the proportional method must make the required computations for each month in the year of change by the due date for the taxpayer's timely filed (including extensions) original federal income tax return implementing the change in method of accounting for the year of change.

.02 At the beginning of each computation period, the taxpayer must determine the following information for each pool of credit card receivables:

(1) The SRPM as of the beginning of the period ("Beginning SRPM"), which is equal to the aggregate balance owed on all credit card receivables included in the pool at the beginning of such period, other than amounts representing charges or fees that are not properly treated as OID (such as finance charges that are qualified stated interest).

(2) The unaccrued OID as of the beginning of the period ("Beginning OID"), which is equal to the OID with respect to the pool at the beginning of such period that has not previously been taken into income.

.03 During each computation period, the taxpayer must determine for each pool of credit card receivables the sum of the payments during the period of amounts that reduce the Beginning SRPM for the period ("SRPM Payments") (equivalently, total payments less amounts that are not included in SRPM, such as charges or fees that are not properly treated as OID).

.04 For each computation period, the taxpayer must compute the OID allocated to the period ("Monthly OID") and include this amount in income for the period. Monthly OID is the product of (1) the Beginning OID multiplied by (2) the quotient of the SRPM Payments divided by the Beginning SRPM.

.05 The formula in section 5.04 of this revenue procedure can be restated as follows:

M_OID = BEG_OID * (SRPM_P / BEG_SRPM),

where

M_OID	= Monthly OID;
BEG_OID	= Beginning OID;
SRPM_P	= SRPM Payments; and
BEG_SRPM	= Beginning SRPM.

.06 For purposes of determining the Beginning SRPM and Beginning OID for a period, the taxpayer should take into account the following items:

(1) The charges and fees relating to the pool for the preceding period that are properly treated as OID;

(2) Credit card accounts transferred into the pool during the preceding period, including any unaccrued OID attributable to the accounts;

(3) Credit card accounts transferred out of the pool during the preceding period, including any unaccrued OID attributable to the accounts; and

(4) Credit card accounts written off during the preceding period, including any unaccrued OID attributable to the accounts.

.07 For purposes of sections 5.06(3) and 5.06(4) of this revenue procedure, the taxpayer may determine the unaccrued OID attributable to an account in a pool as the portion of the unaccrued OID attributable to the pool as of the beginning of the preceding period that is proportional to the SRPM of the account as of the beginning of the preceding period.

.08 If the taxpayer transfers credit card accounts from one of its pools into another one of its pools, the unaccrued OID transferred out of the first pool must be equal to the unaccrued OID transferred into the second pool.

.09 In the case of a pool wholly owned by two or more members of an affiliated group of corporations that file a consolidated return for federal income tax purposes, the members of the group may apply the proportional method to the entire pool and then allocate the OID among the owners, provided that the OID is allocated using a reasonable method. For example, an allocation in proportion to the SRPM attributable to the members' interests in the pool is reasonable.

.10 Section 1.6001–1(a) of the Procedure and Administration Regulations provides that any person subject to tax under subtitle A of the Code shall keep such permanent books of account or records to establish the amount of gross income, deductions, credits, or other matters required to be shown by such person in any return of such tax. To satisfy the recordkeeping requirements of § 6001 and the regulations thereunder, a taxpayer that uses the proportional method of accounting should maintain records supporting all aspects of its method, including, but not limited to, the computations described in section 5 of this revenue procedure.

SECTION 6. EXAMPLES

.01 Example 1. (1) On December 1, for the taxpayer's single pool of credit card receivables, the Beginning SRPM is $100,000,000, and the Beginning OID is $1,000,000. During December, the taxpayer receives SRPM payments of $11,000,000 with respect to the pool.

(2) For December, the taxpayer computes Monthly OID for the pool in the amount of $110,000 ($1,000,000 * ($11,000,000 / $100,000,000)).

.02 Example 2. The facts are the same as in Example 1. In addition, during December, credit card activity, charges, and fees relating to the pool add $14,000,000 to the SRPM and $300,000 to the unaccrued OID, and the taxpayer writes off credit card accounts whose aggregate balance at the beginning of December is $50,000. The taxpayer determines that the unaccrued OID attributable to the written-off accounts is $500 ($1,000,000 * ($50,000 / $100,000,000)). As a result, on January 1, the Beginning SRPM is $102,950,000 ($100,000,000 - $11,000,000 + $14,000,000 - $50,000), and the Beginning OID is $1,189,500 ($1,000,000 - $110,000 + $300,000 - $500).

SECTION 7. EFFECTIVE DATE

This revenue procedure is effective for taxable years that end on or after December 31, 2012.

SECTION 8. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2011–14 is modified by revising section 31.02 to the APPENDIX to read as follows:

SECTION 31.02. Proportional method of accounting for OID on a pool of credit card receivables

(1) *Description of change*. This change applies to a taxpayer that wants to change to the proportional method of accounting for OID on a pool of credit card receivables as described in Rev. Proc. 2013–26, 2013–22 I.R.B. 1160. Under Rev. Proc. 2013–26, a taxpayer may use the proportional method of accounting for a taxable year that ends on or after December 31, 2012.

(2) *Manner of making change*. This change is made on a cut-off basis. Accordingly, a § 481(a) adjustment is neither required nor permitted. The unaccrued OID for the pool as of the beginning of the first period in the year of change is equal to the unaccrued OID for the pool as of the end of the preceding year under the taxpayer's previous method of accounting for the pool. See section 2.06 of this revenue procedure for more information regarding a cut-off basis.

(3) *Waiver of 5-year restriction*. The scope limitation in section 4.02(7) of this revenue procedure does not apply to a change to the proportional method of accounting for OID on a pool of credit card receivables, as described in section 5 of Rev. Proc. 2013–26, for the taxpayer's first or second taxable year ending on or after December 31, 2012.

(4) *Designated automatic accounting method change number*. The designated automatic accounting method change number for a change under section 31.02 of this APPENDIX is "183." See section 6.02(4) of this revenue procedure.

(5) *Contact information*. For further information regarding this section, please contact Charles W. Culmer at (202) 622–3950 (not a toll-free call).

SECTION 9. DRAFTING INFORMATION

The principal author of this revenue procedure is Charles W. Culmer of the Office of Associate Chief Counsel (Financial Institutions & Products). For further information regarding this revenue procedure contact Charles W. Culmer on (202) 622–3950 (not a toll-free call).

Part IV. Items of General Interest

Notice of Proposed Rulemaking

The $500,000 Deduction Limitation for Remuneration Provided by Certain Health Insurance Providers

REG–106796–12

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations on the application of the $500,000 deduction limitation for remuneration provided by certain health insurance providers under section 162(m)(6) of the Internal Revenue Code (Code). These regulations affect health insurance providers that pay such remuneration.

DATES: Written or electronic comments and requests for a hearing must be received by July 1, 2013.

ADDRESSES: Send submissions to CC:PA:LPD:PR (REG–106796–12), Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–106796–12), Courier's Desk Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, DC, or sent electronically via the IRS Internet site via the Federal eRulemaking Portal at *www.regulations.gov* (IRS REG–106796–12).

FOR FURTHER INFORMATION CONTACT: Concerning these proposed regulations, Ilya Enkishev at (202) 622–6030; concerning the submission of comments or to request a public hearing, Oluwafunmilayo (Funmi) Taylor at (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document contains a proposed amendment to 26 CFR part 1 under section 162(m)(6) of the Code. Section 162(m)(6) limits the allowable deduction for remuneration attributable to services provided by applicable individuals to certain health insurance providers that receive premiums from providing health insurance coverage. Section 162(m)(6) was added to the Code by section 9014 of the Patient Protection and Affordable Care Act (ACA) (Public Law 111–148, 124 Stat. 119, 868 (2010)).

On December 23, 2010, the Treasury Department and the IRS released Notice 2011–2, 2011–2 I.R.B. 260, which provides guidance on certain issues under section 162(m)(6). Specifically, the notice provides guidance on the application of the $500,000 deduction limitation to deferred deduction remuneration that is earned during taxable years beginning after December 31, 2009 and before January 1, 2013 and deductible in a taxable year beginning after December 31, 2012. The notice also provides a *de minimis* exception under which a covered health insurance provider is exempt from the deduction limitation if the health insurance premiums received by it and all other entities with which it must be aggregated under section 162(m)(6) are less than two percent of their combined gross revenues. In addition, the notice provides that remuneration subject to section 162(m)(6) does not include remuneration earned by independent contractors who are not subject to section 409A (meaning generally that the independent contractor provides substantial services to multiple unrelated customers). Finally, the notice provides that premiums under a reinsurance contract are not treated as premiums for providing health insurance coverage for purposes of section 162(m)(6).

Notice 2011–2 requested comments on the following issues:

- Application of the term *covered health insurance provider*, including the *de minimis* exception set forth in the notice and possible alternative *de minimis* exceptions;
- How deferred deduction remuneration should be attributed to a taxable year of an employer;
- Application of the term *covered health insurance provider* in the case of a corporate event such as a merger, acquisition, or reorganization; and
- Application of the deduction limitation to remuneration for services performed for insurers who are captive insurance companies or that provide reinsurance or stop loss insurance.

In drafting these proposed regulations, the Treasury Department and the IRS have considered all comments received, many of which are discussed in this preamble. See §601.601(d)(2)(ii)(b).

Explanation of Provisions

For taxable years beginning after December 31, 2012, section 162(m)(6) limits to $500,000 the allowable deduction for the aggregate applicable individual remuneration and deferred deduction remuneration attributable to services performed by an applicable individual for a covered health insurance provider in a disqualified taxable year beginning after December 31, 2012 that (but for section 162(m)(6)) is otherwise deductible under chapter 1 of the Code (referred to in this preamble as remuneration that is otherwise deductible). Deferred deduction remuneration attributable to services performed in a disqualified taxable year beginning after December 31, 2009 and before January 1, 2013 that becomes otherwise deductible in taxable years beginning after December 31, 2012 is also subject to the $500,000 deduction limitation, determined as if the deduction limitation applied to disqualified taxable years beginning after December 31, 2009.

Accordingly, if applicable individual remuneration, deferred deduction remuneration, or a combination of applicable individual remuneration and deferred deduction remuneration that is attributable to services performed by an applicable individual for a covered health insurance provider in a disqualified taxable year exceeds $500,000, the amount of the remuneration that exceeds $500,000 is not allowable as a deduction in any taxable year. To the extent that the aggregate applicable individual remuneration and deferred deduction remuneration attributable to services performed by an applicable individual for a covered health insurance provider in a disqualified taxable year is less than $500,000, the remuneration

generally may be deducted by the covered health insurance provider in the taxable year or years in which the amount is otherwise deductible.

The following example illustrates the application of the section 162(m)(6) deduction limitation. In Year 1, a covered health insurance provider pays $400,000 in salary (applicable individual remuneration) to an applicable individual and also credits $300,000 to an account for the applicable individual under a nonqualified deferred compensation plan, which is payable in Year 5 (deferred deduction remuneration). The $300,000 credit is fully vested in Year 1 and is attributable to services provided by the applicable individual in that year. In Year 1, the covered health insurance provider may deduct the $400,000 of applicable individual remuneration paid to the applicable individual for services provided during that year because the amount of this payment is less than the $500,000 deduction limit. In Year 5, the covered health insurance provider pays the $300,000 that was credited under the nonqualified deferred compensation plan for services provided by the applicable individual in Year 1. Because the aggregated applicable individual remuneration and deferred deduction remuneration attributable to services performed by the applicable individual in Year 1 exceeds the $500,000 deduction limit by $200,000 ($400,000 + $300,000 = $700,000), the covered health insurance provider can deduct only $100,000 of the $300,000 payment in year 5, and the remaining $200,000 is not deductible by the covered health insurance provider in any year.

I. *Covered Health Insurance Provider*

A. *In General*

Section 162(m)(6)(C) provides that a covered health insurance provider is any health insurance issuer described in section 162(m)(6)(C)(i) and certain persons that are treated as a single employer with that health insurance issuer, as described in section 162(m)(6)(C)(ii). These proposed regulations include rules for determining whether a health insurance issuer is a covered health insurance provider for any taxable year and whether a person is treated as a single employer with a health insurance issuer that is a covered health insurance provider for any taxable year. A person may be treated as a covered health insurance provider for one taxable year, but not be treated as a covered health insurance provider for another taxable year, depending on whether that person meets the requirements to be a covered health insurance provider under section 162(m)(6)(C) for a particular taxable year.

B. *Health Insurance Issuers*

For taxable years beginning after December 31, 2009 and before January 1, 2013, section 162(m)(6)(C)(i)(I) provides that a health insurance issuer (as defined in section 9832(b)(2)) is a covered health insurance provider for a taxable year if that health insurance issuer receives premiums from providing health insurance coverage (as defined in section 9832(b)(1)) during the taxable year. For taxable years beginning after December 31, 2012, section 162(m)(6)(C)(i)(II) provides that a health insurance issuer (as defined in section 9832(b)(2)) is a covered health insurance provider for a taxable year if not less than 25 percent of the gross premiums that the provider receives from providing health insurance coverage (as defined in section 9832(b)(1)) during the taxable year are from minimum essential coverage (as defined in section 5000A(f)).

C. *Persons Treated as a Single Employer with a Health Insurance Issuer*

Section 162(m)(6)(C)(ii) provides that two or more persons that are treated as a single employer under sections 414(b), (c), (m), or (o) are treated as a single employer for purposes of determining whether a person is a covered health insurance provider, except that in applying section 1563(a) for purposes of these subsections of section 414, sections 1563(a)(2) and (3) (which provide for brother-sister groups and combined groups) are disregarded. Accordingly, these proposed regulations provide that each member of an aggregated group (as described in the final sentence of this paragraph) that includes a health insurance issuer described in section 162(m)(6)(C)(i) at any time during a taxable year is also a covered health insurance provider for purposes of section 162(m)(6), even if the member is not a health insurance issuer and does not provide health insurance coverage. (An exception for certain corporate transactions is provided in the transition rules described in section IX of this preamble.) For this purpose, these proposed regulations define the term *aggregated group* as a health insurance issuer (as defined in section 9832(b)(2)) and all persons that are treated as a single employer with the health insurance issuer under sections 414(b), (c), (m) or (o), disregarding sections 1563(a)(2) and (3) (with respect to controlled groups of corporations) and §1.414(c)–(2)(c) (with respect to trades or businesses under common control).

For members of an aggregated group that have different taxable years, these proposed regulations provide rules to determine whether a member of an aggregated group that is not a health insurance issuer is a covered health insurance provider for a particular taxable year. Under these rules, the parent entity (as defined in the following paragraph of this preamble) of an aggregated group is a covered health insurance provider for its taxable year with which, or in which, ends the taxable year of the health insurance issuer that is a covered health insurance provider in the aggregated group of which the parent entity is a member. Each other member of an aggregated group is a covered health insurance provider for its taxable year that ends with, or within, the taxable year of the parent entity during which the parent entity is a covered health insurance provider. For purposes of these proposed regulations, the term *parent entity* refers to the common parent of an aggregated group that is a parent-subsidiary controlled group of corporations (within the meaning of section 414(b)) or a parent-subsidiary group of trades or businesses under common control (within the meaning of section 414(c)). With respect to an aggregated group that is an affiliated service group within the meaning of section 414(m) or other group within the meaning of section 414(o), the parent entity is the health insurance issuer in the aggregated group if the aggregated group includes only one health insurance issuer. If an aggregated group that is an affiliated service group within the meaning of section 414(m) or other group within the meaning of section 414(o) includes more than one health insurance issuer, the parent entity is any health insurance issuer in the aggregated group that is designated in writing by the other members of the group as the parent entity for purposes of sec-

tion 162(m)(6), provided that the members of the group treat the health insurance issuer as the parent entity consistently for all taxable years. If the members of an aggregated group that is an affiliated service group or other group fail to designate a parent entity in writing (or fail to apply the designation consistently for all taxable years), the members of the group are deemed to have a parent entity with a taxable year that is the calendar year. A health insurance issuer that has been designated as the parent entity of an aggregated group may leave that group as a result of a merger, disposition, or other corporate transaction; the Treasury Department and the IRS request comments on the circumstances under which a successor parent entity may be designated and any transition rules that may be necessary in this situation.

D. *Self-insurers*

In response to a request for comments in Notice 2011–2, commenters suggested that an employer that sponsors a self-insured medical reimbursement plan should not be treated as a covered health insurance provider because benefits under this type of plan should not be treated as health insurance coverage for purposes of section 162(m)(6) if the employer assumes the financial risk of providing health benefits to its employees and limits the availability of benefits only to employees (which may include former employees). The Treasury Department and the IRS agree that an employer should not be treated as a covered health insurance provider under these circumstances. Accordingly, these proposed regulations provide that an employer is not a covered health insurance provider solely because it maintains a self-insured medical reimbursement plan. For this purpose, the term *self-insured medical reimbursement plan* means a separate written plan for the benefit of employees (which may include former employees) that provides for reimbursement of employee medical expenses referred to in section 105(b) and that does not provide for reimbursement under an individual or group policy of accident or health insurance issued by a licensed insurance company or under an arrangement in the nature of a prepaid health care plan that is regulated under federal or state law in a manner similar to the regulation of insurance companies. An arrangement described in the prior sentence may include a plan maintained by an employee organization described in section 501(c)(9). A captive insurance company, however, is treated as a covered health insurance provider under these proposed regulations if it is a health insurance issuer that is otherwise described in section 162(m)(6)(C).

E. *De Minimis Exception*

1. *In General*

After section 162(m)(6) was enacted, some commenters observed that the aggregation rule in section 162(m)(6)(C)(ii) could result in unintended consequences in situations in which a health insurance issuer's activities and revenue constitute an insignificant portion of the activities and revenue of persons that are treated as a single employer with the health insurance issuer under the aggregation rules. Commenters also suggested that employers that maintain only legacy policies (policies that are no longer sold but for which current policyholders have automatic renewal rights) should not be considered covered health insurance providers because those employers are no longer accepting new policyholders and may find it difficult to transfer the legacy policies for regulatory and other reasons.

In response to these concerns, Notice 2011–2 provides a *de minimis* exception under which a person that would otherwise be a covered health insurance provider under section 162(m)(6)(C)(i)(I) for a taxable year beginning after December 31, 2009 and before January 1, 2013 is not treated as a covered health insurance provider for that taxable year if the premiums received by that person and all other members of its aggregated group from providing health insurance coverage are less than two percent of the gross revenue of that person and all other members of its aggregated group for that taxable year. For taxable years beginning after December 31, 2012, the notice provides that a person that would otherwise be a covered health insurance provider under section 162(m)(6)(C)(i)(II) for a taxable year is not treated as a covered health insurance provider for that taxable year if the premiums received by that person and all other members of its aggregated group from providing health insurance coverage that constitutes minimum essential coverage are less than two percent of the gross revenue of that person and all other members of its aggregated group for that taxable year.

Commenters generally reacted favorably to the *de minimis* exception set forth in Notice 2011–2. One commenter, however, suggested that the *de minimis* exception should be based on compensation instead of revenues. The commenter suggested that a health insurance issuer and the persons that are treated as a single employer with the health insurance issuer under the aggregation rule should not be treated as covered health insurance providers if the compensation paid by the health insurance issuer is less than two percent of the total compensation paid by all members of the aggregated group. The commenter reasoned that comparing compensation rather than gross revenue and premiums would be a better method to measure the importance of the health insurance business to an aggregated group because basing a *de minimis* exception on gross revenue could overemphasize the importance of health insurance activities, which may generate relatively higher revenues but operate on slimmer profit margins. These proposed regulations do not adopt this suggestion. The Treasury Department and the IRS do not agree that comparing compensation paid by the health insurance issuer with the overall compensation paid by the aggregated group would be a better method of measuring the importance of the health insurance business to an aggregated group than comparing premiums with gross revenues. The Treasury Department and the IRS are also concerned that a *de minimis* exception based on compensation would be inadministrable because it would require taxpayers and the IRS to allocate compensation between members of an aggregated group if an individual performs services for more than one member of the aggregated group.

The commenter also suggested that if an individual provides services for a member of an aggregated group, but does not provide any services to the health insurance issuer within the group, then the remuneration for those services should not be subject to the section 162(m)(6) deduction limitation. These proposed regulations

do not adopt this suggestion because that rule would be inconsistent with section 162(m)(6)(C)(ii), which treats all members of an aggregated group that includes a health insurance issuer described in section 162(m)(6)(C)(i) as covered health insurance providers subject to the section 162(m)(6) deduction limitation.

One commenter requested that the two-percent threshold for the *de minimis* exception be increased slightly to an unspecified percentage to avoid treating certain aggregated groups of employers that utilize captive insurance companies as covered health insurance providers. Several other commenters, however, requested that the two-percent threshold not be increased because a higher threshold could allow health insurance issuers that sell significant amounts of health insurance coverage to be exempt from the deduction limitation, and thereby provide them with a competitive advantage. After carefully considering these comments, the Treasury Department and the IRS have concluded that the two-percent threshold remains appropriate. Accordingly, these proposed regulations adopt a *de minimis* exception that is substantially similar to the *de minimis* exception set forth in Notice 2011–2.

To accommodate unexpected changes in the revenue sources of an aggregated group and other events that could affect application of the *de minimis* exception, and also to provide a reasonable period for employers that have not previously been treated as covered health insurance providers to adjust their compensation programs, these proposed regulations provide that if a person is not treated as a covered health insurance provider for one or more taxable years solely by reason of the *de minimis* exception, and then fails to meet the requirements for the *de minimis* exception for one or more taxable years, the person will not be treated as a covered health insurance provider for the first taxable year in which it fails to meet the requirements for the *de minimis* exception after previously not being treated as a covered health insurance provider solely by reason of the *de minimis* exception.

2. *Application of the De Minimis Exception to Aggregated Groups the Members of Which Have Different Taxable Years*

Commenters asked how the *de minimis* exception would apply in situations in which the members of the aggregated group have different taxable years. These proposed regulations provide that the *de minimis* exception applies based on the premiums and gross revenues received for the taxable year of the health insurance issuer and the taxable years of the other members of the aggregated group for which they would otherwise be treated as covered health insurance providers in the absence of the *de minimis* exception. In other words, the *de minimis* exception applies based on the premiums and gross revenues of (i) the health insurance issuer for its taxable year, (ii) the parent entity for its taxable year with which, or in which, ends the taxable year of the health insurance issuer, and (iii) each other member of the aggregated group for its taxable year that ends with, or within, the taxable year of the parent entity.

II. *Premiums*

A. *In General*

Section 162(m)(6)(C)(i) provides that a health insurance issuer is a covered health insurance provider for a taxable year only if it receives premiums from providing health insurance coverage (as defined in section 9832(b)(1)). These proposed regulations include rules specifying that amounts received under an indemnity reinsurance contract and amounts that are direct service payments are not treated as premiums from providing health insurance coverage for purposes of section 162(m)(6)(C)(i).

B. *Amounts Received under an Indemnity Reinsurance Contract*

Health insurance issuers may reinsure a portion of their risks by entering into an indemnity reinsurance contract with a reinsurer. After Congress enacted section 162(m)(6), commenters suggested that premiums received under an indemnity reinsurance contract should not be treated as premiums from providing health insurance coverage. An indemnity reinsurance contract is a contract between a health insurance issuer and a reinsurer under which a reinsurance claim is payable only after the health insurance issuer has paid an amount for health benefits under its own insurance agreement with the policy holder. Thus, commenters reasoned, premiums for reinsurance coverage should not be treated as premiums from providing health insurance coverage for purposes of section 162(m)(6). In response to these comments, Notice 2011–2 provides that, solely for purposes of determining whether a taxpayer is a covered health insurance provider, premiums received under an indemnity reinsurance contract are not treated as premiums from providing health insurance coverage.

Consistent with Notice 2011–2, these proposed regulations provide that, solely for purposes of determining whether a person is a covered health insurance provider, premiums received under an indemnity reinsurance contract are not treated as premiums from providing health insurance coverage, provided that under the reinsurance contract (1) the reinsuring company agrees to indemnify the health insurance issuer for all or part of the risk of loss under policies specified in the agreement, and (2) the health insurance issuer retains its liability to, and its contractual relationship with, the individual insured.

C. *Direct Service Payments*

A health insurance issuer or other person that receives premiums from providing health insurance coverage may enter into an arrangement with a third party to provide, manage, or arrange for the provision of services by physicians, hospitals, or other healthcare providers. In connection with this arrangement, the health insurance issuer or other person that receives premiums from providing health insurance coverage may pay compensation to the third party in the form of capitated, prepaid, periodic, or other payments, and the third party may bear some or all of the risk that the compensation is insufficient to pay the full cost of providing, managing, or arranging for the provision of services by physicians, hospitals, or other healthcare providers as required under the arrangement. In addition, the third party may be subject to healthcare provider, health insurance, licensing, financial solvency, or other regulation under state insurance

law. Commenters suggested that compensation payments to these third parties under these types of arrangements should not be treated as premiums from providing health insurance coverage for purposes of section 162(m)(6) because, while the third party bears some risk in connection with providing, managing, or arranging for the provision of healthcare services, a health insurance issuer or other entity that receives premiums from providing health insurance coverage is ultimately responsible for providing health insurance coverage to the insureds. The commenters explained that these risk shifting arrangements are simply methods by which health insurance issuers and other entities that provide health insurance coverage diversify and manage their risk, in a manner similar to reinsurance. The Treasury Department and the IRS agree with this comment. Accordingly, these proposed regulations provide that capitated, prepaid, periodic, or other payments (referred to as direct service payments) made by a health insurance issuer or other person that receives premiums from providing health insurance coverage to a third party as compensation for providing, managing, or arranging for the provision of healthcare services by physicians, hospitals, or other healthcare providers are not treated as premiums for purposes of section 162(m)(6), regardless of whether the third party is subject to healthcare provider, health insurance, licensing, financial solvency, or other similar regulatory requirements under state law.

The Treasury Department and the IRS also understand that certain government entities may make similar capitated, prepaid, or periodic payments to third parties to provide, manage, or arrange for the provision of services by physicians, hospitals, or other healthcare providers and that these third parties may also bear some or all of the risk that the payments are insufficient to pay the full cost of providing, managing, or arranging for the provision of services subject to the arrangement. Under certain circumstances, it may be inappropriate to treat these payments made by government entities as premiums for purposes of section 162(m)(6). However, because these payments are not made by an entity that has received premiums from providing health insurance, it may be difficult to distinguish between payments made to third parties that should be treated as premiums from providing health insurance and payments that should not be treated as premiums from providing health insurance. The Treasury Department and the IRS request comments on when such payments should be treated as premiums from providing health insurance coverage for purposes of section 162(m)(6) and when they should not be treated as premiums for these purposes.

III. *Disqualified Taxable Year*

Section 162(m)(6)(B) provides that a disqualified taxable year is, with respect to any employer, any taxable year for which the employer is a covered health insurance provider. Consistent with the statutory language, these proposed regulations provide that a disqualified taxable year is, with respect to any person, any taxable year for which that person is a covered health insurance provider.

IV. *Applicable Individual*

Section 162(m)(6)(F) provides that with respect to a covered health insurance provider for a disqualified taxable year, an applicable individual is any individual (i) who is an officer, director, or employee in such taxable year, or (ii) who provides services for, or on behalf of, the covered health insurance provider during the taxable year. As noted in the Background section of this preamble, Notice 2011–2 provides that the term *applicable individual* for a taxable year does not include an independent contractor with respect to whom a compensation arrangement would not be subject to section 409A pursuant to §1.409A–1(f)(2). Section 1.409A–1(f)(2) generally provides an exception from section 409A for arrangements that are made with independent contractors that provide substantial services to multiple unrelated service recipients. Commenters suggested that future guidance adopt this rule for purposes of section 162(m)(6).

These proposed regulations adopt this rule. The proposed regulations provide that remuneration for services provided by an independent contractor to a covered health insurance provider will not be subject to the deduction limitation under section 162(m)(6) if each of the following conditions are met. First, the independent contractor is actively engaged in the trade or business of providing services to recipients, other than as an employee or as a member of the board of directors of a corporation (or in a similar position with respect to an entity that is not a corporation). Second, the independent contractor provides significant services (as defined in §1.409A–1(f)(2)(iii)) to two or more persons to which the independent contractor is not related and that are not related to one another (as defined in §1.409A–1(f)(2)(ii)). Third, the independent contractor is not related to the covered health insurance provider or any member of its aggregated group, applying the definition of related person contained in §1.409A–1(f)(2)(ii), except that for purposes of applying the references to sections 267(b) and 707(b)(1), the language "20 percent" is not substituted for "50 percent" in each place "50 percent" appears in sections 267(b) and 707(b)(1).

Commenters also suggested that future guidance clarify that the section 162(m)(6) deduction limitation applies to services provided by individuals that are natural persons and not services provided pursuant to a contract or arrangement with a corporation or partnership. For example, commenters were concerned that remuneration paid to doctors working for practice groups that provide services to a covered health insurance provider would be subject to the deduction limitation under section 162(m)(6). In general, a corporation or a partnership (for federal tax purposes) would not be treated as an applicable individual. However, the Treasury Department and the IRS remain concerned that covered health insurance providers may attempt to avoid the application of the deduction limitation under section 162(m)(6) by encouraging employees and independent contractors who are natural persons to form small or single-member personal service corporations or other similar entities to provide services that are historically provided by natural persons. The Treasury Department and the IRS invite comments regarding how the final regulations might address this potential abuse.

V. *Applicable Individual Remuneration*

Section 162(m)(6)(D) and these proposed regulations provide that applicable individual remuneration is the aggregate amount that is allowable as a deduction

with respect to an applicable individual for a disqualified taxable year (determined without regard to section 162(m)) for remuneration for services performed by that individual (whether or not during the taxable year), except that applicable individual remuneration does not include any amount that is deferred deduction remuneration. Unlike the definition of remuneration in section 162(m)(1), the definition of applicable individual remuneration in section 162(m)(6)(D) includes remuneration that is performance-based compensation, remuneration payable on a commission basis, and remuneration payable under existing binding contracts. Whether remuneration is applicable individual remuneration is determined without regard to when the services for the remuneration are performed. For example, a discretionary bonus first granted and paid to an applicable individual in a disqualified taxable year solely in recognition of services provided in prior years is applicable individual remuneration for the disqualified taxable year even though the bonus does not relate to services provided in the disqualified taxable year. In addition, a grant of restricted stock in a disqualified taxable year for which an applicable individual makes an election under section 83(b) is applicable individual remuneration for the disqualified taxable year of the covered health insurance provider in which the grant of the restricted stock is made.

VI. *Deferred Deduction Remuneration*

Section 162(m)(6)(E) and these regulations provide that deferred deduction remuneration is remuneration that would be applicable individual remuneration for services that an applicable individual performs during a disqualified taxable year, but for the fact that it is not deductible until a later taxable year (such as generally occurs, for example, with nonqualified deferred compensation). Whether remuneration is deferred deduction remuneration is determined based on when the remuneration is deductible, regardless of when the remuneration is paid. For example, a bonus that is paid within 2½ months after the end of a covered health insurance provider's taxable year in which an applicable individual first obtains a right to the remuneration is deductible in the covered health insurance provider's taxable year in which the applicable individual obtains the right and, therefore, is applicable individual remuneration, rather than deferred deduction remuneration. See section 404(a)(5); §1.404(b)–1T Q&A–2.

VII. *Attribution of Applicable Individual Remuneration and Deferred Deduction Remuneration to Services Performed in Taxable Years*

The $500,000 deduction limitation under section 162(m)(6) applies to the applicable individual remuneration and deferred deduction remuneration that is attributable to services performed by an applicable individual for a covered health insurance provider in a disqualified taxable year. Accordingly, at the time that an amount of applicable individual remuneration or deferred deduction remuneration for an applicable individual becomes otherwise deductible (and not before that time), the remuneration must be attributed to services provided by the applicable individual during a particular taxable year or years of a covered health insurance provider.

In response to a request for comments in Notice 2011–2, some commenters asked that taxpayers be permitted to use any reasonable method to attribute remuneration to taxable years of a covered health insurance provider, as long as the method is applied consistently. Commenters observed that the allocation methods for purposes of section 162(m)(5) set forth in Notice 2008–94 (relating to recipients of payments under the Troubled Asset Relief Program) may not be appropriate for purposes of section 162(m)(6) because the methods in Notice 2008–94 were developed for employers expected to be subject to the deduction limitation under section 162(m)(5) only temporarily, and thus necessarily provided less flexibility than may be appropriate for purposes of section 162(m)(6). Permitting taxpayers to use any reasonable method to attribute remuneration to a taxable year of a covered health insurance provider, however, may lead to results that are inconsistent with section 162(m)(6) and the legislative intent underlying the statute. Accordingly, these proposed regulations provide rules for attributing applicable individual remuneration and deferred deduction remuneration to services performed by an applicable individual during a taxable year or years of a covered health insurance provider. Nonetheless, the Treasury Department and the IRS remain concerned about imposing undue burdens on taxpayers and request comments regarding the ease or difficulty of applying the attribution rules described in these proposed regulations and regarding specific alternatives for attributing applicable individual remuneration and deferred deduction remuneration to services performed during taxable years of a covered health insurance provider that would be less burdensome or otherwise more appropriate.

A. *In General*

These proposed regulations provide that remuneration is attributable to services performed by an applicable individual in the taxable year of the covered health insurance provider in which the applicable individual obtains a legally binding right to the remuneration, unless the remuneration is attributable to a different taxable year under another provision of these regulations.

In addition, these proposed regulations provide that deferred deduction remuneration is not attributable to a taxable year ending before the later of the date that (i) an applicable individual begins providing services to a covered health insurance provider, or (ii) an applicable individual obtains a legally binding right to the remuneration. If any amount of remuneration that becomes otherwise deductible would be attributable under the rules provided in these proposed regulations to a taxable year ending before the applicable individual begins providing services to a covered health insurance provider or obtains a legally binding right to the remuneration, these proposed regulations provide that this remuneration is attributed to services performed by the applicable individual in the taxable year in which the latter of these two dates occurs.

These proposed regulations further provide that remuneration is not attributable to periods when an applicable individual is not a service provider. Solely for purposes of these proposed regulations, an individual is treated as a service provider for any period during which the individual is an officer, director, or employee of, or provid-

ing services for, or on behalf of, a covered health insurance provider or any member of its aggregated group. An amount of remuneration that otherwise would be attributable under the rules set forth in these proposed regulations to a period when an applicable individual is not a service provider must be reattributed to a period during which the applicable individual is a service provider in accordance with the rules set forth in these proposed regulations.[1] Accordingly, for example, compensation such as earnings on an account balance after termination of employment but before payment, or appreciation of a share's fair market value after termination of employment but before the exercise of a stock option or stock appreciation right, must be attributed to the period during which the applicable individual is a service provider.

If an amount of remuneration that becomes otherwise deductible may be attributed to services performed by an applicable individual in two or more taxable years of a covered health insurance provider in accordance with the rules for attributing remuneration set forth in the immediately following sections of this preamble for attributing remuneration under an account balance plan or a nonaccount balance plan, the amount must be attributed first to services performed by the applicable individual in the earliest taxable year to which the amount could be attributed under the applicable attribution rules, and then to the next subsequent taxable year to which the amount could be attributed under those attribution rules, until the entire amount has been attributed to one or more taxable years of the covered health insurance provider.

B. *Account Balance Plans*

To minimize the administrative burden on taxpayers in applying the remuneration attribution rules for account balance plans (as described in §1.409A–1(c)(2)(i)(A) and (B)), these proposed regulations provide that remuneration for an account balance plan may be attributed to a taxable year based on the increase in the account balance during the taxable year, taking into account adjustments for the amount of any payments from that account during the taxable year. This method of attributing remuneration is referred to in the proposed regulations as the standard attribution method. Under the standard attribution method, the amount of remuneration attributable to services performed in a taxable year of a covered health insurance provider is equal to the excess of the account balance as of the last day of the taxable year, plus any payments made from that account during the taxable year, over the account balance as of the last day of the immediately preceding taxable year. Any net decrease in an account balance during a taxable year (again after adding back payments made under the plan during the taxable year) is treated as a reduction to deferred deduction remuneration for that taxable year and may offset other deferred deduction remuneration (but not applicable individual remuneration) attributable to services performed by the applicable individual in that year. If there is not sufficient other deferred deduction remuneration for that taxable year to offset the entire reduction, the excess may offset deferred deduction remuneration in the first subsequent taxable year or years in which the applicable individual has deferred deduction remuneration to be offset by the loss.

Under the standard attribution method, any increases or decreases in an account balance that occur in taxable years in which an applicable individual is not a service provider must be attributed to taxable years of the covered health insurance provider (i) during which the applicable individual is a service provider, and (ii) on one or more days of which the applicable individual retains an account balance under the plan. The Treasury Department and the IRS request comments on the appropriate method for attributing this remuneration to these taxable years. For taxable years beginning in 2013, and thereafter until the Treasury Department and the IRS issue further guidance prescribing the method for attributing this remuneration to these taxable years, this remuneration may be attributed using any reasonable method to taxable years of the covered health insurance provider (i) during which the applicable individual is a service provider, and (ii) on one or more days of which the applicable individual retains an account balance under the plan. For this purpose, a method is reasonable only if it is consistent with a reasonable, good faith interpretation of section 162(m)(6) and is applied consistently for all remuneration provided by the covered health insurance provider under substantially similar plans or arrangements.

These proposed regulations provide an alternative method for attributing increases and decreases in account balance plans to services performed during a taxable year of a covered health insurance provider. Under the alternative attribution method, earnings and losses on a principal addition (including earnings and losses that occur in taxable years during which an applicable individual is not a service provider) are attributed to the taxable year in which an applicable individual is credited with the principal addition under the plan. For example, if a principal addition is credited to the account balance of an applicable individual for the 2014 taxable year, earnings (or losses) on that principal addition in 2028 are treated as additional deferred deduction remuneration (or reductions to deferred deduction remuneration) for the 2014 taxable year, and not the 2028 taxable year.

After an amount of remuneration has been attributed to a taxable year under a particular attribution method (for example, because a payment has been made and the amount of the payment becomes otherwise deductible), it is administratively difficult for the attribution method to be changed for future years. In addition, the Treasury Department and the IRS are concerned that the ability to change attribution methods may lead to selective use of methods to maximize deductions. Therefore, these proposed regulations provide that a covered health insurance provider must use the method chosen to attribute remuneration under all of its account balance plans consistently for all taxable years. However, the Treasury Department and the IRS understand that there may be valid business reasons for changing attribution methods, such as a

[1] These proposed regulations apply solely for purposes of section 162(m)(6), and therefore have no effect on the determination whether an amount is remuneration attributable to a particular taxable year for employment tax purposes, and thus wages subject to federal employment taxation (including the Federal Insurance Contributions Act, the Federal Unemployment Tax Act, the Railroad Retirement Tax Act, and the Collection of Income Tax at Source on Wages (chapters 21, 22, 23, and 24 of the Code)), or the timing or amount of any applicable federal employment taxation.

merger or acquisition, change in compensation structure, or change in accounting method. Accordingly, the Treasury Department and the IRS request comments on the standards that should be applied to determine whether and when a method may be changed, and how that change would apply if deductions for some portion of the deferred deduction remuneration have already been taken.

C. *Nonaccount Balance Plans*

These proposed regulations provide that remuneration under a nonaccount balance plan (as described in §1.409A–1(c)(2)(i)(C)) is attributable to services performed by an applicable individual in a taxable year based on the increase (or decrease) in the present value of the applicable individual's benefit under the plan during the taxable year. Under this method, the amount of remuneration attributable to services performed in a taxable year of a covered health insurance provider is equal to the increase (or decrease) in the present value of the future payment or payments due under the plan as of the last day of the taxable year of the covered health insurance provider, increased by any payments made during that year, over (or under) the present value of the future payment or payments as of the last day of the covered health insurance provider's preceding taxable year. For purposes of determining the increase (or decrease) in the present value of a future payment or payments, the rules of §31.3121(v)(2)–1(c)(2) apply. Like losses under account balance plans, losses attributable to any taxable year under a nonaccount balance plan may offset other deferred deduction remuneration attributable to services performed by the applicable individual in that year (or, if there is not sufficient other deferred deduction remuneration for that taxable year to offset the entire reduction, the excess may offset deferred deduction remuneration in the first subsequent taxable year or years in which the applicable individual has deferred deduction remuneration to be offset by the loss).

Any increase (or decrease) in the present value of a future payment or payments under a nonaccount balance plan that occurs in a taxable year when an applicable individual is not a service provider must be attributed to taxable years of the covered health insurance provider during which the applicable individual (i) is a service provider and (ii) has a legally binding right to a future payment or payments under the nonaccount balance plan. The Treasury Department and IRS request comments on the appropriate method for attributing this remuneration to these taxable years. For taxable years beginning in 2013, and thereafter until the Treasury Department and the IRS issue further guidance prescribing the method for attributing this remuneration to these taxable years, this remuneration may be attributed using any reasonable method to taxable years during which the applicable individual (i) is a service provider and (ii) has a legally binding right to the future payment or payments. For this purpose, a method is reasonable only if it is consistent with a reasonable, good faith interpretation of section 162(m)(6) and is applied consistently for all remuneration provided by the covered health insurance provider under substantially similar plans or arrangements.

D. *Equity-Based Remuneration*

These proposed regulations provide specific rules for the attribution of equity-based remuneration to services performed in specific taxable years. They provide that remuneration resulting from the exercise of stock options and stock appreciation rights (SARs) generally is attributable, on a daily *pro rata* basis, to services performed by the applicable individual over the period beginning on the date of grant of the stock option or SAR and ending on the date that the stock right is exercised, excluding any days on which an applicable individual is not a service provider.

These proposed regulations further provide that remuneration resulting from the vesting or transfer (or transferability) of restricted stock for which an election under section 83(b) has not been made generally is attributable, on a daily *pro rata* basis, to services performed by the applicable individual over the period beginning on the grant date of the restricted stock and ending on the earliest of the date on which (i) the substantial risk of forfeiture lapses or (ii) the restricted stock is transferred (or becomes transferable), excluding any days on which an applicable individual is not a service provider.

These proposed regulations provide that remuneration resulting from restricted stock units (RSUs) is generally attributable, on a daily *pro rata* basis, to services performed over the period beginning on the date the applicable individual obtains the legally binding right to the RSU and ending on the date the remuneration is paid or made available such that it is includible in gross income, excluding any days on which an applicable individual is not a service provider.

E. *Involuntary Separation Pay*

These proposed regulations provide that involuntary separation pay is attributable to services performed by an applicable individual during the taxable year of the covered health insurance provider in which the involuntary separation from service occurs. Alternatively, involuntary separation pay may be attributable, on a daily *pro rata* basis, to services performed by the applicable individual beginning on the date that the applicable individual obtains a legally binding right to the involuntary separation pay and ending on the date of the applicable individual's involuntary separation from service with the covered health insurance provider and all members of its aggregated group. Involuntary separation pay to different individuals may be attributed using different methods; however, if involuntary separation payments are made to the same individual over multiple taxable years, all the payments must be attributed using the same method. These regulations define involuntary separation pay as remuneration to which an applicable individual obtains a right to payment solely as a result of an involuntary separation from service. For these purposes, an involuntary separation from service means an involuntary separation from service under §1.409A–1(n).

F. *Substantial Risk of Forfeiture*

An applicable individual's right to remuneration may be subject to a substantial risk of forfeiture. In response to Notice 2011–2, commenters suggested that remuneration be attributed to services performed over the period during which amounts are subject to a substantial risk

of forfeiture (the vesting period). Consistent with this suggestion, these proposed regulations provide that in the case of remuneration that is subject to a substantial risk of forfeiture and that would otherwise be attributed to taxable years of a covered health insurance provider in accordance with (i) the general rule that attributes remuneration to the taxable year in which an applicable individual obtains a legally binding right to the remuneration, (ii) the attribution rules applicable to account balance plans, or (iii) the attribution rules applicable to nonaccount balance plans, the remuneration is attributed to taxable years of the covered health insurance provider using a two-step process. First, the remuneration is attributed to taxable years of the covered health insurance provider pursuant to the legally-binding-right rule or the rules applicable to account balance or nonaccount balance plans, as applicable. Second, the remuneration that was subject to a substantial risk of forfeiture is reattributed on a daily *pro rata* basis over the period that the remuneration was subject to a substantial risk of forfeiture (in other words, reattributed evenly over the vesting period).

If a vesting period ends on a day other than the last day of the covered health insurance provider's taxable year, the remuneration attributable to that taxable year under the first step of the attribution process is divided between the portion of the taxable year that includes the vesting period and the portion of the taxable year that does not include the vesting period. The amount attributed to the portion of the taxable year that includes the vesting period is equal to the total amount of remuneration that would be attributable to the taxable year under the first step of the attribution process, multiplied by a fraction, the numerator of which is the number of days during the taxable year that the amount is subject to a substantial risk of forfeiture and the denominator of which is the number of days in such taxable year. The remaining amount is attributed to the portion of the taxable year that does not include the vesting period and, therefore, is not reattributed over the vesting period under the second step of the attribution process.

For purposes of these proposed regulations, a substantial risk of forfeiture means a substantial risk of forfeiture under §1.409A–1(d). If an individual makes an election pursuant to section 83(b), then the remuneration included in the individual's gross income is applicable individual remuneration that is attributed to the year in which the transfer of the property occurs.

VIII. *Application of the $500,000 Deduction Limitation*

A. *In General*

The section 162(m)(6) deduction limitation applies to the aggregate applicable individual remuneration and deferred deduction remuneration attributable to services performed by an applicable individual for a covered health insurance provider in a disqualified taxable year. Accordingly, if the applicable individual remuneration and deferred deduction remuneration attributable to services performed by an applicable individual for a covered health insurance provider in a disqualified taxable year exceed $500,000, the amount of the remuneration that exceeds $500,000 is not allowable as a deduction in any taxable year.

B. *Timing of Application of the Deduction Limitation*

The $500,000 deduction limitation with respect to the applicable individual remuneration and deferred deduction remuneration attributable to services performed by an applicable individual in a disqualified taxable year is applied to that remuneration at the time that the remuneration otherwise becomes deductible. The deduction limitation with respect to an applicable individual for any particular disqualified taxable year is applied first to any applicable individual remuneration attributable to services performed by the applicable individual in that disqualified taxable year. If the amount of the applicable individual remuneration is less than the $500,000 deduction limitation, all of the applicable individual remuneration is deductible by the covered health insurance provider in that disqualified taxable year. To the extent the applicable individual remuneration exceeds the $500,000 deduction limitation, the covered health insurance provider's deduction for the applicable individual remuneration is limited to $500,000, and the amount of the applicable individual remuneration that exceeds $500,000 and, if applicable, any deferred deduction remuneration attributable to services performed by the applicable individual in that disqualified taxable year, cannot be deducted in any taxable year.

When the $500,000 deduction limitation is applied to an amount of applicable individual remuneration attributable to services performed by an applicable individual in a disqualified taxable year, the deduction limitation with respect to that applicable individual for that disqualified taxable year is reduced by the amount of the applicable individual remuneration against which it is applied, but not below zero. If the applicable individual also has an amount of deferred deduction remuneration attributable to services performed in that disqualified taxable year that becomes otherwise deductible in a subsequent taxable year, the deduction limitation, as reduced, is applied to that amount of deferred deduction remuneration in the first taxable year in which it becomes otherwise deductible. If the amount of the deferred deduction remuneration that becomes otherwise deductible is less than the reduced deduction limitation, then the full amount of the deferred deduction remuneration is deductible in that taxable year. To the extent that the amount of the deferred deduction remuneration exceeds the reduced deduction limitation, the covered health insurance provider's deduction for the deferred deduction remuneration is limited to the amount of the reduced deduction limitation and the amount of the deferred deduction remuneration that exceeds the deduction limitation cannot be deducted in any taxable year.

After the deduction limitation with respect to an applicable individual for a disqualified taxable year (the original disqualified taxable year) is applied to an amount of deferred deduction remuneration, the deduction limitation with respect to that applicable individual for the original disqualified taxable year is further reduced by the amount of the deferred deduction remuneration against which it is applied, but not below zero. If the applicable individual has an additional amount of deferred deduction remuneration attributable to services performed in the original disqualified taxable year that becomes otherwise deductible in a subsequent taxable year, the deduction limitation, as further reduced, is applied to that amount

of deferred deduction remuneration in the taxable year in which it is otherwise deductible. This process continues for future taxable years in which deferred deduction remuneration attributable to services performed by the applicable individual in the original disqualified taxable year is otherwise deductible. No deduction is allowed for any applicable individual remuneration or deferred deduction remuneration to the extent that remuneration exceeds the deduction limitation in effect at the time it is applied to the remuneration.

C. *Application of Deduction Limitation to Payments of Deferred Deduction Remuneration*

Any payment of deferred deduction remuneration may include remuneration that is attributable to services performed by an applicable individual in one or more taxable years of a covered health insurance provider under the rules set out in these proposed regulations. For example, remuneration resulting from the vesting of restricted stock that is subject to a substantial risk of forfeiture for three full taxable years of a covered health insurance provider is attributable to services performed in each of the three years during which the restricted stock was subject to a substantial risk of forfeiture. In that case, a separate deduction limitation applies to each portion of the payment that is attributed to services performed in a different disqualified taxable year of the covered health insurance provider. Any portion of the payment that is attributed to a disqualified taxable year will be deductible only to the extent that it does not exceed the deduction limit that applies to the applicable individual for that disqualified taxable year, as that deduction limit may have been previously reduced by the amount of any applicable individual remuneration or deferred deduction remuneration attributable to services performed in that disqualified taxable year that was previously deductible. If payments of deferred deduction remuneration under an account balance plan or a nonaccount balance plan are paid in installments (rather than a single lump-sum), the payments are deemed to be made from the deferred deduction remuneration to which they are attributable under the applicable attribution rules, with payments deemed to be made first with respect to the earliest taxable years to which they could be attributed. The proposed regulations contain numerous examples to illustrate how these rules apply to services performed and compensation payments made over multiple taxable years.

D. *Application of the Deduction Limitation to an Aggregated Group*

For purposes of applying the section 162(m)(6) deduction limitation, all members of an aggregated group are treated as a single employer. Accordingly, one $500,000 deduction limitation applies to the aggregate applicable individual remuneration and deferred deduction remuneration attributable to services performed by an applicable individual during a disqualified taxable year for any member of the aggregated group. Each time this deduction limitation is applied to an amount of applicable individual remuneration or deferred deduction remuneration otherwise deductible by any member of the aggregated group, the deduction limitation is reduced by the amount of the remuneration against which it is applied, and the reduced deduction limitation is then applied to other remuneration attributable to services performed by the applicable individual in the original disqualified taxable year that is otherwise deductible by any member of the aggregated group, in the manner previously described.

In the case of two or more members of an aggregated group that are otherwise entitled to deduct in any taxable year applicable individual remuneration or deferred deduction remuneration attributable to services performed by an applicable individual in a disqualified taxable year that exceeds the applicable deduction limitation for that disqualified taxable year, the deduction limitation is prorated and allocated to the members of the aggregated group in proportion to the applicable individual remuneration or deferred deduction remuneration that each otherwise would be entitled to deduct in the taxable year (but for section 162(m)(6)).

IX. *Corporate Transactions*

A corporation or other person may become a covered health insurance provider as a result of a merger, acquisition of assets or stock, disposition, reorganization, consolidation, or separation, or any other transaction (including a purchase or sale of stock or other equity interest) resulting in a change in the composition of its aggregated group (generally referred to in these proposed regulations as a corporate transaction). For example, as a result of the aggregation rules, members of a controlled group of corporations may become covered health insurance providers if a health insurance issuer that is a covered health insurance provider becomes a member of the controlled group. In response to Notice 2011–2, commenters suggested that if a person becomes a covered health insurance provider as a result of a corporate transaction, the person should not be treated as a covered health insurance provider for the taxable year in which the corporate transaction occurs. These proposed regulations adopt this suggestion by providing transition period relief to ease the administrative burden on persons that become covered health insurance providers solely as a result of a corporate transaction. Specifically, these proposed regulations provide that if a person that is not otherwise a covered health insurance provider would become a covered health insurance provider solely as a result of a corporate transaction, the person generally is not treated as a covered health insurance provider for the taxable year in which the transaction occurs (referred to as the transition period). The corporation or other person, however, is treated as a covered health insurance provider for any subsequent taxable year for which it qualifies as a covered health insurance provider under the general rules for determining whether a person is a covered health insurance provider. A person that was a covered health insurance provider immediately before a corporate transaction is not eligible for this transition period relief because the person did not become a covered health insurance provider solely as a result of a corporate transaction.

However, these proposed regulations provide that in certain circumstances the deduction limitation under section 162(m)(6) may apply to a person that is not treated as a covered health insurance provider during the transition period. Specifically, these proposed regulations provide that transition period relief does not extend to remuneration provided to applicable individuals of a health insurance issuer that is a covered health insurance

provider (which is not eligible for the transition period because it does not become a covered health insurance provider solely as a result of a corporate transaction) by other members of the acquiring aggregated group that are otherwise eligible for the transition period relief. For example, if a health insurance issuer that is a covered health insurance provider becomes a member of an acquiring aggregated group that is a consolidated group described in §1.1502–1(h), the other members of which are not treated as covered health insurance providers in the year in which the corporate transaction occurs because of the transition period relief, then any applicable individual remuneration and deferred deduction remuneration attributable to services provided by an applicable individual of the health insurance issuer for the health insurance issuer or for the other members of the acquiring aggregated group during the transition period are subject to the deduction limitation of section 162(m)(6).

These proposed regulations also provide rules for covered health insurance providers that have short taxable years as a result of a corporate transaction. See proposed §1.162–31(f).

X. *Grandfathered Amounts Attributable to Services Performed Before January 1, 2010*

The section 162(m)(6) deduction limitation only applies to applicable individual remuneration attributable to services performed by an applicable individual during taxable years beginning after December 31, 2012 and to deferred deduction remuneration attributable to services performed by an applicable individual during taxable years beginning after December 31, 2009. It does not apply to remuneration attributable to services performed during taxable years beginning before January 1, 2010. These proposed regulations provide rules for determining whether remuneration is attributable to services performed in taxable years beginning before January 1, 2010 that are in some ways different from the general attribution rules.

Commenters suggested that deferred deduction remuneration earned or granted in taxable years beginning before January 1, 2010, be attributed to services performed before that time, regardless of whether the remuneration was subject to a substantial risk of forfeiture after that time. Commenters reasoned that Congress did not intend for the deduction limitation to apply to remuneration attributable to taxable years starting before January 1, 2010 (even if such remuneration was not vested as of the first day of the taxable year beginning after December 31, 2009), because Congress enacted section 162(m)(6) to encourage the use of health insurance coverage premiums to lower insurance rates for taxable years beginning after December 31, 2012 (when health insurance issuers would begin to benefit from a substantial increase in new customers). Commenters also asserted that the statute should not apply to arrangements that existed before the statute was enacted because covered health insurance providers could not change those arrangements unilaterally in response to the statute.

In response to these comments, these proposed regulations provide that the section 162(m)(6) deduction limitation does not apply to deferred deduction remuneration attributable to services performed during taxable years beginning before January 1, 2010, regardless of whether the remuneration was subject to a substantial risk of forfeiture after that time. These proposed regulations provide special rules for determining the amount of remuneration attributable to services performed in taxable years beginning before January 1, 2010 with respect to account balance plans, nonaccount balance plans, and equity-based remuneration. For account balance plans and nonaccount balance plans, these proposed regulations provide that amounts are attributed based on the general attribution rules, except that any substantial risk of forfeiture is disregarded. For equity-based compensation, any remuneration resulting from equity-based compensation granted in a taxable year beginning before January 1, 2010, is not subject to the deduction limitation. Earnings on these grandfathered amounts, including earnings accruing in taxable years beginning after December 31, 2009, are also generally treated as remuneration attributable to services performed in taxable years beginning before January 1, 2010.

XI. *Transition Rules for Certain Deferred Deduction Remuneration*

Section 162(m)(6) applies to deferred deduction remuneration attributable to services performed in a disqualified taxable year beginning after December 31, 2009 that is otherwise deductible in a taxable year beginning after December 31, 2012. As described in section I.B of this preamble, for taxable years beginning before January 1, 2013, a covered health insurance provider is any health insurance issuer (as defined in section 9832(b)(2)) that receives premiums from providing health insurance coverage (as defined in section 9832(b)(1)) (a pre-2013 covered health insurance provider). For taxable years beginning after December 31, 2012, a covered health insurance provider is any health insurance issuer (as defined in section 9832(b)(2)) that receives at least 25 percent of its gross premiums from providing minimum essential coverage (as defined in section 5000A(f)) (a post-2012 covered health insurance provider). Thus, the definition of the term *covered health insurance provider* is narrower for taxable years beginning after December 31, 2012, than it is for taxable years beginning before January 1, 2013.

After the enactment of section 162(m)(6), commenters suggested that if a pre-2013 covered health insurance provider does not qualify as a post-2012 covered health insurance provider, the section 162(m)(6) deduction limitation should not apply to deferred deduction remuneration attributable to services performed during taxable years when the health insurance issuer was a pre-2013 covered health insurance provider. These commenters cited legislative history suggesting that section 162(m)(6) was enacted to encourage health insurance issuers to use premiums from new customers to lower health insurance rates. 155 Cong. Rec. S12,540 (Dec. 6, 2009) (statement of Sen. Lincoln). These commenters reasoned that if a pre-2013 covered health insurance provider is not also a post-2012 covered health insurance provider, the health insurance issuer is not benefiting from new customers who are paying premiums for minimum essential coverage, and the health insurance issuer should not be subject to the deduction limitation.

In response to these comments, Notice 2011–2 provides that the section 162(m)(6) deduction limitation applies to deferred deduction remuneration attributable to services performed in a taxable year beginning after December 31, 2009 and before January 1, 2013 only if the covered health insurance provider is a pre-2013 covered health insurance provider for the taxable year to which the deferred deduction remuneration is attributable and a post-2012 covered health insurance provider for the taxable year in which that deferred deduction remuneration is otherwise deductible. These proposed regulations adopt this transition rule.

In response to Notice 2011–2, some commenters requested that the transition rule be applied more broadly, so that the section 162(m)(6) deduction limitation would not apply to deferred deduction remuneration for services attributable to taxable years beginning before January 1, 2013 if the employer is not a covered health insurance provider in 2013, regardless of whether the employer is a covered health insurance provider for the year the deferred deduction remuneration becomes otherwise deductible. The Treasury Department and the IRS have concluded that the standard set forth in Notice 2011–2 appropriately limits the transition rule to circumstances in which the deferred deduction remuneration is otherwise deductible in a taxable year for which the covered health insurance provider is not a post-2013 covered health insurance provider, and therefore these proposed regulations do not adopt this suggestion.

Effect on Other Documents

These proposed regulations do not affect the applicability of Notice 2011–2, 2011–2 I.R.B. 260. However, upon the effective date of the final regulations, the Treasury Department and the IRS anticipate that Notice 2011–2 will become obsolete for periods after the effective date of the final regulations.

Proposed Effective Date

These proposed regulations are proposed to be effective upon publication in the **Federal Register** of a Treasury decision adopting these rules as final regulations, and applicable to taxable years that begin after December 31, 2012, and end on or after April 2, 2013. Taxpayers may rely on these proposed regulations until the issuance of final regulations. The Treasury Department and the IRS anticipate that the final regulations will be issued before a covered health insurance provider is required to file an income tax return reflecting application of the section 162(m)(6) deduction limitation. However, to the extent the final regulations contain rules more restrictive than the rules contained in these proposed regulations, a covered health insurance provider will be able to rely on these proposed regulations for the purposes of the application of the section 162(m)(6) to its first taxable year beginning after December 31, 2012. Although these regulations will not apply to taxable years beginning after December 31, 2012 and ending before April 2, 2013, taxpayers may rely on these proposed regulations with respect to those taxable years to the same extent as taxpayers may rely with respect to taxable years to which the regulations will apply.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, this regulation has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or electronic comments that are timely submitted to the IRS. Treasury and the IRS request comments on all aspects of the proposed rules. All comments will be available for public inspection and copying. A public hearing will be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the **Federal Register**.

Drafting Information

The principal author of these proposed regulations is Ilya Enkishev, Office of the Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from Treasury Department and the IRS participated in their development.

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Proposed Amendments to the Regulations

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

PART 1—INCOME TAXES

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

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

Par. 2. Section 1.162–31 is added to read as follows:

§1.162–31 The $500,000 deduction limitation for remuneration provided by certain health insurance providers.

(a) *Scope*. This §1.162–31 provides rules regarding the deduction limitation under section 162(m)(6), which provides that a covered health insurance provider's deduction for applicable individual remuneration and deferred deduction remuneration attributable to services performed by an applicable individual in a disqualified taxable year is limited to $500,000. Paragraph (b) of this section provides definitions of the terms used in this section. Paragraph (c) of this section states the general limitation on deductions under section 162(m)(6). Paragraph (d) of this section provides rules on the attribution of applicable individual remuneration and deferred deduction remuneration to services provided in one or more taxable years of a covered health insurance provider. Paragraph (e) of this section provides rules on the application of the deduction limitation to applicable individual remuneration and deferred deduction remuneration that is otherwise deductible

under chapter 1 of the Internal Revenue Code (Code) but for the deduction limitation under section 162(m)(6) (referred to in these regulations as remuneration that is otherwise deductible). Paragraph (f) of this section provides rules for persons participating in certain corporate transactions. Paragraph (g) of this section provides rules on the coordination of section 162(m)(6) with sections 162(m)(1) and 280G. Paragraph (h) of this section provides rules for determining the amount of remuneration that is not subject to the deduction limitation under section 162(m)(6) due to application of the statutory effective date (referred to in these regulations as grandfathered amounts). Paragraph (i) of this section provides transition rules for deferred deduction remuneration that is attributable to services performed in taxable years beginning after December 31, 2009 and before January 1, 2013. Paragraph (j) of this section provides the effective and applicability dates of the rules in this section.

(b) *Definitions*—(1) *Health insurance issuer*. For purposes of this section, a *health insurance issuer* is a health insurance issuer as defined in section 9832(b)(2).

(2) *Aggregated group*. For purposes of this section, an *aggregated group* is a health insurance issuer and each other person that is treated as a single employer with the health insurance issuer at any time during the taxable year of the health insurance issuer under sections 414(b) (controlled groups of corporations), 414(c) (partnerships, proprietorships, etc. under common control), 414(m) (affiliated service groups), or 414(o), except that the rules in section 1563(a)(2) and (a)(3) (with respect to corporations) and the rules in §1.414(c)–2(c) (with respect to trades or businesses under common control) for brother-sister groups and combined groups are disregarded.

(3) *Parent entity*—(i) *In general*. For purposes of this section, a *parent entity* is either—

(A) the common parent of a parent-subsidiary controlled group of corporations (within the meaning of section 414(b)) or a parent-subsidiary group of trades or businesses under common control (within the meaning of section 414(c)) that includes a health insurance issuer, or

(B) the health insurance issuer in an aggregated group that is an affiliated service group (within the meaning of section 414(m)) or a group described in section 414(o).

(ii) *Certain aggregated groups with multiple health insurance issuers*. If two or more health insurance issuers are members of an aggregated group that is an affiliated service group (within the meaning of section 414(m)) or group described in section 414(o), the parent entity is the health insurance issuer in the aggregated group that is designated in writing by the other members of the group to act as the parent entity, provided the group treats that health insurance issuer as the parent entity consistently for all taxable years. If the members of a group that are required to designate in writing a health insurance issuer to act as a parent entity fail to do so, or if the members of the group fail to treat the health insurance issuer that they have designated as the parent entity consistently as such for all taxable years, the parent entity of the group is deemed to be an entity with a taxable year that is the calendar year (without regard to whether the aggregated group includes an entity with a calendar year taxable year) for all purposes under this section for which a parent entity's taxable year is relevant.

(4) *Covered health insurance provider*—(i) *In general*. For purposes of this section and except as otherwise provided in this paragraph (b)(4), a *covered health insurance provider* is—

(A) a health insurance issuer for any of its taxable years beginning after December 31, 2009 and before January 1, 2013 in which it receives premiums from providing health insurance coverage (as defined in section 9832(b)(1)),

(B) a health insurance issuer for any of its taxable years beginning after December 31, 2012 in which at least 25 percent of the gross premiums it receives from providing health insurance coverage (as defined in section 9832(b)(1)) are from providing minimum essential coverage (as defined in section 5000A(f)),

(C) the parent entity of an aggregated group of which one or more health insurance issuers described in paragraphs (b)(4)(i)(A) or (B) of this section are members for the taxable year of the parent entity with which, or in which, ends the taxable year of any such health insurance issuer, and

(D) each other member of an aggregated group of which one or more health insurance issuers described in paragraphs (b)(4)(i)(A) or (B) of this section are members for the taxable year of the other member ending with, or within, the parent entity's taxable year.

(ii) *Self-insured plans*. For purposes of this section, a person is not a covered health insurance provider solely because it maintains a self-insured medical reimbursement plan. For this purpose, a self-insured medical reimbursement plan is a separate written plan for the benefit of employees (including former employees) that provides for reimbursement of medical expenses referred to in section 105(b) and does not provide for reimbursement under an individual or group policy of accident or health insurance issued by a licensed insurance company or under an arrangement in the nature of a prepaid health care plan that is regulated under federal or state law in a manner similar to the regulation of insurance companies, and may include a plan maintained by an employee organization described in section 501(c)(9).

(iii) *De minimis exception*—(A) *In general*. A health insurance issuer and any member of its aggregated group that would otherwise be a covered health insurance provider under paragraph (b)(4)(i) of this section for a taxable year beginning after December 31, 2009 and before January 1, 2013 is not treated as a covered health insurance provider for purposes of this section for that taxable year if the premiums received by the health insurance issuer and any other health insurance issuers in its aggregated group from providing health insurance coverage (as defined in section 9832(b)(1)) are less than two percent of the gross revenues of the health insurance issuer and all other members of its aggregated group for the taxable year that the health insurance issuer and the other members of its aggregated group would otherwise be treated as covered health insurance providers under paragraph (b)(4)(i) of this section. A health insurance issuer and any member of its aggregated group that would otherwise be a covered health insurance provider under paragraph (b)(4)(i) of this section for a taxable year beginning after December 31, 2012 is not treated as a covered health insurance provider un-

der this section for that taxable year if the premiums received by the health insurance issuer and any other health insurance issuers in its aggregated group for providing health insurance coverage (as defined in section 9832(b)(1)) that constitutes minimum essential coverage (as defined in section 5000A(f)) are less than two percent of the gross revenues of the health insurance issuer and all other members of its aggregated group for the taxable year that the health insurance issuer and the other members of its aggregated group would otherwise be treated as covered health insurance providers under paragraph (b)(4)(i) of this section. In determining whether premiums constitute less than two percent of gross revenues, the amount of premiums and gross revenues must be determined in accordance with generally accepted accounting principles.

(B) *One-year grace period*. If a health insurance issuer or a member of an aggregated group is not treated as a covered health insurance provider for a taxable year solely by reason of the *de minimis* exception described in paragraph (b)(4)(iii)(A) of this section, but fails to meet the requirements of the *de minimis* exception described in paragraph (b)(4)(iii)(A) of this section for the immediately following taxable year, that health insurance issuer or member of an aggregated group will not be treated as a covered health insurance provider for that immediately following taxable year.

(C) *Examples*. The following examples illustrate the principles of this paragraph (b)(4). For purposes of these examples, each corporation has a taxable year that is the calendar year, unless the example provides otherwise.

Example 1. (i) Corporations Y and Z are members of an aggregated group under paragraph (b)(2) of this section. Y is a health insurance issuer that is a covered health insurance provider pursuant to paragraph (b)(4)(i)(B) of this section and receives premiums from providing health insurance coverage that is minimum essential coverage during its 2015 taxable year in an amount that is less than two percent of the combined gross revenues of Y and Z for their 2015 taxable years. Z is not a health insurance issuer.

(ii) Y and Z are not treated as covered health insurance providers within the meaning of paragraph (b)(4) of this section for their 2015 taxable years because they meet the requirements of the *de minimis* exception under paragraph (b)(4)(iii)(A) of this section.

Example 2. (i) Corporations V, W, and X are members of an aggregated group under paragraph (b)(2) of this section. V is a health insurance issuer that is a covered health insurance provider pursuant to paragraph (b)(4)(i)(B) of this section, but neither W nor X is a health insurance issuer. W is the parent entity of the aggregated group. V's taxable year ends on December 31, W's taxable year ends on June 30, and X's taxable year ends on September 30. For its taxable year ending December 31, 2016, V receives $3x of premiums from providing minimum essential coverage and has no other revenue. For its taxable year ending June 30, 2017, W has $100x in gross revenue. For its taxable year ending September 30, 2016, X has $60x in gross revenue.

(ii) In the absence of the *de minimis* exception, V (the health insurance issuer) would be a covered health insurance provider for its taxable year ending December 31, 2016. W (the parent entity) would be a covered health insurance provider for its taxable year ending June 30, 2017 (its taxable year with which, or within which, ends the taxable year of the health insurance issuer), and X (the other member of the aggregated group) would be a covered health insurance provider for its taxable year ending on September 30, 2016 (its taxable year ending with, or within, the taxable year of the parent entity). However, the premiums received by V (the health insurance issuer) from providing minimum essential coverage during the taxable year that it would otherwise be treated as a covered health insurance provider under paragraph (b)(4)(i)(B) of this section are less than two percent of the combined gross revenues of V, W, and X for the related taxable years that they would otherwise be treated as covered health insurance providers under paragraph (b)(4)(i) of this section ($3x is less than two percent of $163x). Therefore, the *de minimis* exception of paragraph (b)(4)(iii)(A) of this section applies, and V, W, and X are not treated as covered health insurance providers for these taxable years.

Example 3. (i) The facts are the same as *Example 2*, except that V receives $4x of premiums for providing minimum essential coverage for its taxable year ending June 30, 2016. In addition, the members of the V, W, and X aggregated group were not treated as covered health insurance providers for their taxable years ending December 31, 2015, June 30, 2016, and September 30, 2015, respectively (their immediately preceding taxable years) solely by reason of the *de minimis* exception of paragraph (b)(4)(iii)(A) of this section.

(ii) Although the premiums received by the members of the aggregated group from providing minimum essential coverage are more than two percent of the gross revenues of the aggregated group for the taxable years during which the members would otherwise be treated as covered health insurance providers under paragraph (b)(4)(i) of this section ($4x is greater than two percent of $164x), they were not treated as covered health insurance providers for their immediately preceding taxable years solely by reason of the *de minimis* exception of paragraph (b)(4)(iii)(A) of this section. Therefore, V, W, and X are not treated as covered health insurance providers for their taxable years ending in December 31, 2016, June 30, 2017, and September 30, 2016, respectively, because of the one-year grace period under paragraph (b)(4)(iii)(B) of this section. However, the members of the V, W, and X aggregated group will be covered health insurance providers for their subsequent taxable years if they would otherwise be covered health insurance providers for those taxable years under paragraph (b)(4) of this section.

(5) *Premiums*—(i) For purposes of paragraph (b)(4) of this section, the term *premiums* means amounts received by a health insurance issuer from providing health insurance coverage (as defined in section 9832(b)(1)), except that premiums do not include—

(A) amounts received under an indemnity reinsurance contract described in paragraph (b)(5)(ii) of this section, or

(B) direct service payments described in paragraph (b)(5)(iii) of this section.

(ii) *Indemnity reinsurance contract*. For purposes of this paragraph (b)(5), the term *indemnity reinsurance contract* means an agreement between a health insurance issuer and a reinsuring company under which—

(A) The reinsuring company agrees to indemnify the health insurance issuer for all or part of the risk of loss under policies specified in the agreement, and

(B) The health insurance issuer retains its liability to provide health insurance coverage (as defined in section 9832(b)(1)) to, and its contractual relationship with, the insured.

(iii) *Direct service payments*. For purposes of this paragraph (b)(5), the term *direct service payment* means a capitated, prepaid, periodic, or other payment made by a health insurance issuer or another entity that receives premiums from providing health insurance coverage (as defined in section 9832(b)(1)) to another organization as compensation for providing, managing, or arranging for the provision of healthcare services by physicians, hospitals, or other healthcare providers, regardless of whether the organization that receives the compensation is subject to healthcare provider, health insurance, health plan licensing, financial solvency, or other similar regulatory requirements under state insurance law.

(6) *Disqualified taxable year*. For purposes of this section, the term *disqualified taxable year* means, with respect to any person, any taxable year for which the person is a covered health insurance provider.

(7) *Applicable individual*—(i) *In general*. For purposes of this section, except as provided in paragraph (b)(7)(ii) of this section, the term *applicable individual* means, with respect to any covered

health insurance provider for any disqualified taxable year, any individual—

(A) who is an officer, director, or employee in that taxable year, or

(B) who provides services for or on behalf of the covered health insurance provider during that taxable year.

(ii) *Independent contractors*—Remuneration for services provided by an independent contractor to a covered health insurance provider is subject to the deduction limitation under section 162(m)(6). However, an independent contractor will not be treated as an applicable individual with respect to a covered health insurance provider for a disqualified taxable year if each of the following requirements is satisfied:

(A) The independent contractor is actively engaged in the trade or business of providing services to recipients, other than as an employee or as a member of the board of directors of a corporation (or similar position with respect to an entity that is not a corporation);

(B) The independent contractor provides significant services (as defined in §1.409A–1(f)(2)(iii)) to two or more persons to which the independent contractor is not related and that are not related to one another (as defined in §1.409A–1(f)(2)(ii)); and

(C) The independent contractor is not related to the covered health insurance provider or any member of its aggregated group, applying the definition of related person contained in §1.409A–1(f)(2)(ii), subject to the modification that for purposes of applying the references to sections 267(b) and 707(b)(1), the language "20 percent" is not used instead of "50 percent" each place "50 percent" appears in sections 267(b) and 707(b)(1).

(8) *Service provider*. For purposes of this section, the term *service provider* means, with respect to a covered health insurance provider for any period, an individual who is an officer, director, or employee, or who provides services for, or on behalf of, the covered health insurance provider or any member of its aggregated group.

(9) *Remuneration*—(i) *In general*. For purposes of this section, except as provided in paragraph (b)(9)(ii) of this section, the term *remuneration* has the same meaning as applicable employee remuneration, as defined in section 162(m)(4), but without regard to the exceptions under section 162(m)(4)(B) (remuneration payable on a commission basis), section 162(m)(4)(C) (performance-based compensation), and section 162(m)(4)(D) (existing binding contracts), and the regulations under those sections.

(ii) *Exceptions*. For purposes of this section, remuneration does not include—

(A) A payment made to, or for the benefit of, an applicable individual from or to a trust described in section 401(a) within the meaning of section 3121(a)(5)(A),

(B) A payment made under an annuity plan described in section 403(a) within the meaning of section 3121(a)(5)(B),

(C) A payment made under a simplified employee pension plan described in section 408(k)(1) within the meaning of section 3121(a)(5)(C),

(D) A payment made under an annuity contract described in section 403(b) within the meaning of section 3121(a)(5)(D),

(E) Salary reduction contributions described in section 3121(v)(1), and

(F) Remuneration consisting of any benefit provided to, or on behalf of, an employee if, at the time the benefit is provided, it is reasonable to believe that the employee will be able to exclude the value of the benefit from gross income.

(10) *Applicable individual remuneration*. For purposes of this section, the term *applicable individual remuneration* means, with respect to any applicable individual for any disqualified taxable year, the aggregate amount allowable as a deduction under this chapter for that taxable year (determined without regard to section 162(m)) for remuneration for services performed by that applicable individual (whether or not in that taxable year), except that applicable individual remuneration does not include any deferred deduction remuneration with respect to services performed during any taxable year. Applicable individual remuneration for a disqualified taxable year may include remuneration for services performed in a taxable year before the taxable year in which the deduction for the remuneration is allowable. For example, a discretionary bonus granted and paid to an applicable individual in a disqualified taxable year in recognition of services performed in prior taxable years is applicable individual remuneration for that disqualified taxable year. In addition, a grant of restricted stock in a disqualified taxable year with respect to which an applicable individual makes an election under section 83(b) is applicable individual remuneration for the disqualified taxable year of the covered health insurance provider in which the grant of the restricted stock is made. See paragraphs (d)(1)(iv) and (d)(5)(v) of this section for certain remuneration that is not treated as applicable individual remuneration for purposes of this section.

(11) *Deferred deduction remuneration*. For purposes of this section, the term *deferred deduction remuneration* means remuneration that would be applicable individual remuneration for services performed in a disqualified taxable year but for the fact that the deduction (determined without regard to section 162(m)(6)) for the remuneration is allowable in a subsequent taxable year. Whether remuneration is deferred deduction remuneration is determined without regard to when the remuneration is paid, except to the extent that the timing of the payment affects the taxable year in which the remuneration is otherwise deductible. For example, payments that are otherwise deductible by a covered health insurance provider in an initial taxable year, but are paid to an applicable individual by the 15th day of the third month of the immediately subsequent taxable year of the covered health insurance provider (as described in §1.404(b)–1T, Q&A–2(b)(1)), are applicable individual remuneration for the initial taxable year (and not deferred deduction remuneration) because the deduction for the payments is allowable in the initial taxable year, and not a subsequent taxable year. Except as otherwise provided in paragraph (i) of this section (regarding transition rules for certain deferred deduction remuneration attributable to services performed in taxable years beginning before January 1, 2013), deferred deduction remuneration that is attributable to services performed in a disqualified taxable year of a covered health insurance provider is subject to the section 162(m)(6) deduction limitation even if the taxable year in which the remuneration is otherwise deductible is not a disqualified taxable year. Similarly, deferred deduction remuneration is subject to the section 162(m)(6) deduction limitation regardless of whether an applicable individual is a service provider of the covered health insurance provider in the

taxable year in which the deferred deduction remuneration is otherwise deductible. However, remuneration that is attributable to services performed in a taxable year that is not a disqualified taxable year is not deferred deduction remuneration even if the remuneration is otherwise deductible in a disqualified taxable year. See also paragraphs (d)(1)(iv) and (d)(5)(v) of this section for certain remuneration that is not treated as deferred deduction remuneration for purposes of this section.

(12) *Substantial risk of forfeiture*. For purposes of this section, the term *substantial risk of forfeiture* has the same meaning as provided in §1.409A–1(d).

(c) *Deduction Limitation*—(1) *Applicable individual remuneration*. For any disqualified taxable year beginning after December 31, 2012, no deduction is allowed under this chapter for applicable individual remuneration that is attributable to services performed by an applicable individual in that taxable year to the extent that the amount of that remuneration exceeds $500,000.

(2) *Deferred deduction remuneration*. For any taxable year beginning after December 31, 2012, no deduction is allowed under this chapter for deferred deduction remuneration that is attributable to services performed by an applicable individual in any disqualified taxable year beginning after December 31, 2009, to the extent that the amount of such remuneration exceeds $500,000 reduced (but not below zero) by the sum of:

(i) the applicable individual remuneration for that applicable individual for that disqualified taxable year; and

(ii) the portion of the deferred deduction remuneration for those services that was deductible under section 162(m)(6)(A)(ii) and this paragraph (c)(2) in a preceding taxable year, or would have been deductible under section 162(m)(6)(A)(ii) and this paragraph (c)(2) in a preceding taxable year if section 162(m)(6) was effective for taxable years beginning after December 31, 2009 and before January 1, 2013.

(d) *Services to which remuneration is attributable*—(1) *Attribution to a taxable year*—(i) *In general*. The deduction limitation under section 162(m)(6) applies to applicable individual remuneration and deferred deduction remuneration attributable to services performed by an applicable individual in a disqualified taxable year of a covered health insurance provider. When an amount of applicable individual remuneration or deferred deduction remuneration becomes otherwise deductible (and not before that time), that remuneration must be attributed to services performed by an applicable individual in a taxable year of the covered health insurance provider in accordance with the rules of this paragraph (d). After the remuneration has been attributed to services performed by an applicable individual in a taxable year of a covered health insurance provider, the rules of paragraph (e) of this section are then applied to determine whether the deduction with respect to the remuneration is limited by section 162(m)(6).

(ii) *Attribution of deferred deduction remuneration to earliest years first*. If an amount of deferred deduction remuneration that becomes otherwise deductible may be attributed to services performed by an applicable individual in two or more taxable years of a covered health insurance provider in accordance with paragraphs (d)(3) (providing for the attribution of amounts credited under an account balance plan) or (d)(4) (providing for the attribution of amounts credited under a nonaccount balance plan) of this section, the amount must be attributed first to services performed by the applicable individual in the earliest year to which the amount could be attributable under paragraphs (d)(3) or (4) of this section, as applicable, and then to the next subsequent taxable year or years to which the amount could be attributable under paragraphs (d)(3) or (4) of this section, as applicable, until the entire amount has been attributed to one or more taxable years of the covered health insurance provider.

(iii) *Example*. The following example illustrates the principles of paragraph (d)(1)(ii) of this section.

Example. (i) A is an employee of corporation Z, which has a taxable year that is the calendar year and is a covered health insurance provider for all relevant taxable years. A participates in a nonqualified deferred compensation plan that is an account balance plan maintained by Z. A's account balances under the plan on the last day of all relevant taxable years are as follows: $10,000 for 2014, $13,000 for 2015, $17,000 for 2016, and $24,000 for 2017. A's account balance is fully vested at all times. In accordance with the terms of the plan, Z pays $15,000 to A in 2018 and $9,000 to A in 2019. These amounts are otherwise deductible by Z in the year in which they are paid.

(ii) Because the nonqualified deferred compensation plan is an account balance plan, deferred deduction remuneration provided under the plan is attributable to services provided by A in accordance with paragraph (d)(3)(i) of this section. Z does not use the alternate method of allocating earnings and losses permitted under paragraph (d)(3)(ii) of this section. Accordingly, the deferred deduction remuneration under the plan attributable to services provided by A in a taxable year is generally equal to the increase in the account balance on the last day of each taxable year over the account balance on the last day of the immediately preceding taxable year, increased by the amount of any payments made during the taxable year. The increases in A's account balances are $10,000 for 2014, $3,000 for 2015, $4,000 for 2016, and $7,000 for 2017. Therefore, pursuant to paragraph (d)(1)(ii), Z must attribute $10,000 of the $15,000 payment to services performed by A in 2014, $3,000 of the $15,000 payment to services performed by A in 2015, and $2,000 of the $15,000 payment to services performed by A in 2016 (leaving $2,000 remaining to be attributed to 2016). Similarly, Z must attribute $2,000 of the $9,000 payment to services performed by A in 2016, and the remaining $7,000 of the $9,000 payment to services performed by A in 2017.

(iv) *No attribution to taxable years during which no services are performed or before a legally binding right arises*—(A) *In general*. For purposes of this section, remuneration is not attributable—

(*1*) to a taxable year of a covered health insurance provider ending before the later of the date the applicable individual begins providing services to the covered health insurance provider (or any member of its aggregated group) and the date the applicable individual obtains a legally binding right to the remuneration, or

(*2*) to any other taxable year of a covered health insurance provider during which the applicable individual is not a service provider.

(B) *Attribution of remuneration before commencement of services or legally binding right*. To the extent that remuneration would otherwise be attributed to a taxable year ending before the later of the date the applicable individual begins providing services to the covered health insurance provider (or any member of its aggregated group) and the date the applicable individual obtains a legally binding right to the remuneration in accordance with paragraphs (d)(2) through (d)(8) or paragraph (d)(10) of this section, the remuneration is attributable to services provided in the taxable year in which the latter of these dates occurs. For example, if an applica-

ble individual obtains a contractual right to remuneration in a taxable year of a covered health insurance provider and the remuneration would otherwise be attributable to that taxable year pursuant to paragraph (d)(2) of this section, but the applicable individual does not begin providing services to the covered health insurance provider until the next taxable year, the remuneration is attributable to the taxable year in which the applicable individual begins providing services.

(v) *Attribution to 12-month periods*. To the extent that a covered health insurance provider is required to attribute remuneration on a daily *pro rata* basis under this paragraph (d), it may assume that any 12-month period has 365 days (and so may ignore the extra day in leap years).

(vi) *Remuneration subject to nonlapse restriction or similar formula*. For purposes of this section, if stock or other equity is subject to a nonlapse restriction (as defined in §1.83–3(h)), or if the remuneration payable to an applicable individual is determined under a formula that, if applied to stock or other equity, would be a nonlapse restriction, the amount of the remuneration and the attribution of that remuneration to taxable years must be determined based upon application of the nonlapse restriction or formula. For example, if the earnings or losses on an account under an account balance plan are determined based upon the performance of company stock, the valuation of which is based on a formula that if applied to the stock would be a nonlapse restriction, then that formula must be used consistently for purposes of determining the amount of the remuneration credited to that account balance to taxable years and the attribution of that remuneration to taxable years.

(2) *Legally binding right*. Unless remuneration is attributable to services performed in a different taxable year pursuant to paragraphs (d)(3) through (d)(8) or paragraph (d)(10) of this section, the remuneration is attributable to services performed in the taxable year of a covered health insurance provider in which an applicable individual obtains a legally binding right to the remuneration. An applicable individual does not have a legally binding right to remuneration if the remuneration may be reduced unilaterally or eliminated by the covered health insurance provider or other person after the services creating the right to the remuneration have been performed. However, if the facts and circumstances indicate that the discretion to reduce or eliminate the remuneration is available or exercisable only upon a condition, or the discretion to reduce or eliminate the remuneration lacks substantive significance, the applicable individual will be considered to have a legally binding right to the remuneration. For this purpose, remuneration is not considered to be subject to unilateral reduction or elimination merely because it may be reduced or eliminated by operation of the objective terms of a plan, such as the application of a nondiscretionary, objective provision creating a substantial risk of forfeiture.

(3) *Account balance plans*—(i) *Standard attribution method*—(A) *In general*. Except as provided in paragraphs (d)(3)(i)(B) and (d)(3)(ii) of this section, the increase (or decrease) in the account balance of an applicable individual under a plan described in §1.409A–1(c)(2)(i)(A) or (B) (an account balance plan) as of the last day of a taxable year of the covered health insurance provider (the measurement date), over (or under) the account balance as of the last day of the immediately preceding taxable year, is attributable to services provided by the applicable individual in the taxable year that includes the measurement date. For purposes of determining the increase (or decrease) in an account balance in any taxable year, the applicable individual's account balance as of the last day of the taxable year that includes the measurement date is increased by any payments made during that taxable year that reduce the account balance. If an account balance plan credits income or earnings based on a method or formula that is neither a predetermined actual investment within the meaning of §31.3121(v)(2)–1(d)(2)(i)(B) nor a rate of interest that is reasonable within the meaning of §31.3121(v)(2)–1(d)(2)(i)(B), the excess of the amount that would be credited as income or earnings under the terms of the plan over the amount that would be credited as income or earnings under a reasonable rate of interest (as described in §31.3121(v)(2)–1(d)(2)(iii)) must be included in the account balance. Increases in the applicable individual's account balance with respect to any taxable year are treated as remuneration attributable to services performed during that taxable year. Decreases in the applicable individual's account balance with respect to any taxable year are treated as reductions to deferred deduction remuneration for that taxable year and may offset other deferred deduction remuneration (but not applicable individual remuneration) attributable to services performed by the applicable individual during that taxable year under any plan or arrangement (or if there is not sufficient deferred deduction remuneration for that taxable year to offset the reduction entirely, the excess may offset deferred deduction remuneration in first subsequent taxable year or years in which the applicable individual has deferred deduction remuneration to be offset by the loss).

(B) *Attribution of increases (or decreases) in an account balance in taxable years during which an applicable individual is not a service provider*. [Reserved].

(ii) *Alternative attribution method*—(A) *Attribution of principal additions*—(*1*) *In general*. Except as provided in paragraph (d)(3)(ii)(A)(*2*), any increase in the account balance of an applicable individual in an account balance plan as of the last day of a taxable year, increased by any payments made during the taxable year, over the account balance as of the last day of the immediately preceding taxable year that is not due to earnings or losses (as described in paragraph (d)(3)(ii)(C) of this section) is treated as a principal addition and is remuneration attributable to services performed during that taxable year.

(*2*) *Attribution of principal additions in taxable years during which an applicable individual is not a service provider*. [Reserved].

(B) *Attribution of earnings or losses*. Earnings or losses on a principal addition (including earnings and losses arising after an applicable individual ceases to be a service provider) are attributable to the services provided by the applicable individual in the same disqualified taxable year of the covered health insurance provider to which the principal addition is attributed in accordance with paragraph (d)(3)(ii)(A) of this section. Earnings are treated as remuneration for the taxable year to which they are attributed, and losses are treated as reductions to deferred deduction remuneration for that taxable year and may offset other deferred deduction remuneration

(but not applicable individual remuneration) attributable to services performed by the applicable individual during that taxable year (or if there is not sufficient deferred deduction remuneration to offset the reduction entirely during that taxable year, the first subsequent taxable year or years in which the applicable individual has deferred deduction remuneration to be offset by the loss, if applicable).

(C) *Earnings*. Whether remuneration constitutes earnings on a principal addition is determined under the principles defining income attributable to an amount taken into account under §31.3121(v)(2)–1(d)(2). Therefore, for an account balance plan (as defined in §31.3121(v)(2)–1(c)(1)(ii)(A)), earnings on an amount deferred generally include an amount credited on behalf of the applicable individual under the terms of the arrangement that reflects a rate of return that does not exceed either the rate of return on a predetermined actual investment (as defined in §31.3121(v)(2)–1(d)(2)(i)(B)), or, if the income does not reflect the rate of return on a predetermined actual investment, a reasonable rate of interest. For purposes of this section, the use of an unreasonable rate of return generally will result in the treatment of some or all of the remuneration as a principal addition that is attributable to services provided by an applicable individual in a taxable year of a covered health insurance provider in accordance with paragraph (d)(3)(ii)(A) of this section. For purposes of determining whether an account balance plan has a reasonable rate of return, the rules of §31.3121(v)(2)–1(d)(2)(iii)(A) apply.

(D) *Consistency requirement*. If a covered health insurance provider applies a method described in either paragraph (d)(3)(i) or paragraph (d)(3)(ii) of this section, the covered health insurance provider must apply that method consistently for all taxable years for all plans of the covered health insurance provider that would be aggregated and treated as a single account balance plan under §1.409A–1(c)(2) if one hypothetical applicable individual had deferrals of compensation under all of the plans described in this paragraph.

(4) *Nonaccount balance plans*—(i) *In general*. The increase (or decrease) in the present value of the future payment or payments to which an applicable individual has a legally binding right under a plan described in §1.409A–1(c)(2)(i)(C) (nonaccount balance plan) as of a measurement date (as defined in paragraph (d)(3)(i)), over (or under) the present value of the future payment or payments as of the last day of the immediately preceding taxable year is attributable to services provided by the applicable individual in the taxable year of the covered health insurance provider that includes the measurement date. For purposes of determining the increase (or decrease) in the present value of a future payment or payments under a nonaccount balance plan, the rules of §31.3121(v)(2)–1(c)(2) apply (including the requirement that reasonable actuarial assumptions and methods be used). For purposes of determining the increase (or decrease) in the present value of a future payment or payments under a nonaccount balance plan attributable to any taxable year, the present value of the future payment or payments as of the last day of the taxable year is increased by the amount of any payments made during that taxable year. Increases in the present value of the future payment or payments to which an applicable individual has a legally binding right under a nonaccount balance plan with respect to any taxable year are treated as remuneration attributable to services performed in that taxable year. Decreases in the present value of the future payment or payments to which an applicable individual has a legally binding right under a nonaccount balance plan with respect to any taxable year are treated as reductions to deferred deduction remuneration for that taxable year and may offset other deferred deduction remuneration (but not applicable individual remuneration) attributable to services performed by the applicable individual during that taxable year under any plan or arrangement (or if there is not sufficient deferred deduction remuneration for that taxable year to offset the reduction entirely, the excess may offset deferred deduction remuneration in the first subsequent taxable year or years in which the applicable individual has deferred deduction remuneration to be offset by the loss).

(ii) *Attribution of increases (or decreases) in the present value of a future payment or payments in taxable years during which an applicable individual is not a service provider*. [Reserved].

(5) *Equity-based remuneration*—(i) *Stock options and stock appreciation rights*. Remuneration resulting from the exercise of a stock option (including an incentive stock option described in section 422 and an option under an employee stock purchase plan described in section 423) or a stock appreciation right (SAR) is attributable to services performed by an applicable individual for a covered health insurance provider, and it must be allocated on a daily *pro rata* basis over the period beginning on the date of grant (within the meaning of §1.409A–1(b)(5)(vi)(B)) of the stock option or SAR and ending on the date that the stock right is exercised, excluding any days on which the applicable individual is not a service provider.

(ii) *Restricted stock*. Remuneration resulting from the vesting or transfer of restricted stock for which an election under section 83(b) has not been made is attributable on a daily *pro rata* basis to services performed by an applicable individual for a covered health insurance provider over the period, excluding any days on which the applicable individual is not a service provider, beginning on the date the applicable individual obtains a legally binding right to the restricted stock and ending on the earliest of—

(A) the date the substantial risk of forfeiture lapses with respect to the restricted stock, or

(B) the date the restricted stock is transferred by the applicable individual (or becomes transferable as defined in §1.83–3(d)).

(iii) *Restricted stock units*. Remuneration resulting from a restricted stock unit (RSU) is attributable to services performed by an applicable individual for a covered health insurance provider, and must be allocated on a daily *pro rata* basis, over the period beginning on the date the applicable individual obtains a legally binding right to the RSU and ending on the date the remuneration is paid or made available such that it is includible in gross income, excluding any days on which the applicable individual is not a service provider.

(iv) *Partnership interests and other equity*. The rules provided in this paragraph (d)(5) may be applied by analogy to grants of equity-based compensation in situations in which the compensation is determined by reference to equity in an entity treated as a partnership for federal tax purposes, or

where compensation is determined by reference to equity interests in an entity described in §1.409A–1(b)(5)(iii) (for example, a mutual company).

(6) *Involuntary separation pay*. Involuntary separation pay is attributable to services performed by an applicable individual for a covered health insurance provider in the taxable year in which the involuntary separation from service occurs. Alternatively, the covered health insurance provider may attribute involuntary separation pay to services performed by an applicable individual on a daily *pro rata* basis beginning on the date that the applicable individual obtains a legally binding right to the involuntary separation pay and ending on the date of the involuntary separation from service. Involuntary separation pay to different individuals may be attributed using different methods; however, if involuntary separation payments are made to the same individual over multiple taxable years, all the payments must be attributed using the same method. For purposes of this section, the term *involuntary separation pay* means remuneration to which an applicable individual has a right to payment solely as a result of the individual's involuntary separation from service (within the meaning of §1.409A–1(n)).

(7) *Reimbursements*. Remuneration that is provided in the form of a reimbursement or benefit provided in-kind (other than cash) is attributable to services performed by an applicable individual in the taxable year of the covered health insurance provider in which the applicable individual makes a payment for which the applicable individual has a right to reimbursement or receives the in-kind benefit, except that remuneration provided in the form of a reimbursement or in-kind benefit during a taxable year of the covered health insurance provider in which an applicable individual is not a service provider is attributable to services provided in the first preceding taxable year of the covered health insurance provider in which the applicable individual is a service provider.

(8) *Split-dollar life insurance*. Remuneration resulting from a split-dollar life insurance arrangement (as defined in §1.61–22(b)) under which an applicable individual has a legally binding right to economic benefits described in §1.61–22(d)(2)(ii) (policy cash value to which the non-owner has current access within the meaning of §1.61–22(d)(4)(ii)) or §1.61–22(d)(2)(iii) (any other economic benefits provided to the non-owner) is attributable to services performed in the taxable year of the covered health insurance provider in which the legally binding right arises. Split-dollar life insurance arrangements under which payments are treated as split-dollar loans under §1.7872–15 generally will not give rise to deferred deduction remuneration within the meaning of paragraph (b)(11) of this section, although they may give rise to applicable individual remuneration. However, in certain situations, this type of arrangement may give rise to deferred deduction remuneration for purposes of section 162(m)(6), for example, if amounts on a split-dollar loan are waived, cancelled, or forgiven.

(9) *Examples*. The following examples illustrate the principles of paragraphs (d)(1) through (8) of this section. For purposes of these examples, each corporation has a taxable year that is the calendar year and is a covered health insurance provider for all relevant taxable years; deferred deduction remuneration is otherwise deductible in the taxable year in which it is paid, and amounts payable under nonaccount balance plans are not forfeitable upon the death of the applicable individual.

Example 1 (Account balance plan with earnings using the standard attribution method). (i) B is an applicable individual of corporation Y for all relevant taxable years. On January 1, 2016, B begins participating in a nonqualified deferred compensation plan of Y that is an account balance plan. Under the terms of the plan, all amounts are fully vested at all times, and Y will pay B's entire account balance on January 1, 2019. Y credits $10,000 to B under the plan annually on January 1 for three years beginning on January 1, 2016. The account earns interest at a fixed rate of five percent per year, compounded annually under the terms of the plan, which solely for purposes of this example, is assumed to be a reasonable rate of interest. Thus, B's account balance is $10,500 ($10,000 + ($10,000 x 5%)) on December 31, 2016; $21,525 ($10,500 + $10,000 + ($20,500 x 5%)) on December 31, 2017; and $33,101 ($21,525 + $10,000 + ($31,525 x 5%)) on December 31, 2018. Y attributes increases and decreases in account balances under the plan using the standard allocation method described in paragraph (d)(3)(i) of this section.

(ii) Under the standard attribution method for account balance plans described in paragraph (d)(3)(i) of this section, any increase in B's account balance as of the last day of Y's taxable year over the account balance as of the last day of the immediately preceding taxable year, increased by any payments made during the taxable year, is remuneration that is attributable to services provided by B in that taxable year. Accordingly, $10,500 of deferred deduction remuneration is attributable to services performed by B in Y's 2016 taxable year (the difference between the $10,500 account balance on December 31, 2016 and the zero account balance on December 31, 2015); $11,025 of deferred deduction remuneration is attributable to services performed in Y's 2017 taxable year (the difference between the $21,525 account balance on December 31, 2017 and the $10,500 account balance on December 31, 2016); and $11,576 of deferred deduction remuneration is attributable services performed in Y's 2018 taxable year (the difference between the $33,101 account balance on December 31, 2018 and the $21,525 account balance on December 31, 2017).

Example 2 (Account balance plan with earnings using the alternate attribution method). (i) The facts are the same as in *Example 1*, except that Y allocates earnings and losses based on the alternative attribution method described in paragraph (d)(3)(ii) of this section.

(ii) Under the alternative attribution method described in paragraph (d)(3)(ii) of this section, each principal addition of $10,000 is attributed to the taxable year of Y as of which the addition is credited, and earnings and losses on each principal addition are attributed to the same taxable year to which the principal addition is attributed. Therefore, $1,576 of earnings are attributable to Y's 2016 taxable year (interest on the 2016 $10,000 principal addition at five percent for three years compounded annually); $1,025 of earnings are attributable to Y's 2017 taxable year (interest on the 2017 $10,000 principal addition at five percent for two years compounded annually); and $500 of earnings are attributable to Y's 2018 taxable year (interest on the 2018 $10,000 principal addition at five percent for one year).

Example 3 (Account balance plan with earnings and losses using the standard attribution method). (i) The facts are the same as in *Example 1*, except that the earnings under the terms of the plan are based on a notional investment in a predetermined actual investment (as defined in §31.3121(v)(2)–1(e)(2)(i)(B)), which results in B's account balance increasing by five percent in the 2016 taxable year, decreasing by five percent in the 2017 taxable year, and increasing again by five percent in the 2018 taxable year. Therefore, on December 31, 2016, B's account balance is $10,500 ($10,000 + ($10,000 x 5%)); on December 31, 2017, B's account balance is $19,475 ($10,500 + $10,000 - ($20,500 x 5%)); and on December 31, 2018, B's account balance is $30,479 ($19,475 + $10,000 + ($29,475 x 5%)).

(ii) Under the standard attribution method for account balance plans described in paragraph (d)(3)(i) of this section, increases (or decreases) in B's account balance as of the last day of Y's taxable year over (or under) the account balance as of the last day of the immediately preceding taxable year, increased by any payments made during the taxable year, are attributable to services provided by B in that taxable year.

(iii) Accordingly, $10,500 of deferred deduction remuneration is attributable to services performed by B in Y's 2016 taxable year (the difference between the $10,500 account balance on December 31, 2016 and the zero account balance on December 31, 2015); $8,975 of deferred deduction remuneration is attributable to services performed in Y's 2017 taxable year (the difference between the $19,475 account balance on December 31, 2017 and the $10,500 account bal-

ance on December 31, 2016); and $11,474 of deferred deduction remuneration is attributable to services performed in Y's 2018 taxable year (the difference between the $30,949 account balance on December 31, 2018 and the $19,475 account balance on December 31, 2017).

Example 4 (Account balance plan with earnings and losses using the alternative attribution method). (i) The facts are the same as in *Example 3*, except that Y attributes earnings and losses based on the method described in paragraph (d)(3)(ii) of this section.

(ii) Under the alternative attribution method for account balance plans described in paragraph (d)(3)(ii) of this section, each $10,000 principal addition is attributed to the taxable year of Y as of which the addition is made, and earnings and losses on each principal addition are attributed to the same taxable year of Y to which the principal addition is attributed. With respect to the $10,000 principal addition to B's account for 2016, the account balance is $10,500 on December 1, 2016 ($500 of earnings), $9,975 on December 31, 2017 ($525 of losses), and $10,474 on December 31, 2018 ($499 of earnings). Accordingly, $474 ($500 - $525 + $499) of net earnings is attributable to Y's 2016 taxable year. With respect to the $10,000 principal addition to B's account for 2017, the account balance is $9,500 on December 31, 2017 ($500 of losses), and $9,975 on December 31, 2018 ($475 of earnings). Accordingly, $25 in net losses are attributable to Y's 2017 taxable year ($500 losses for 2017 and $475 earnings for 2018). Because losses attributable to a taxable year may reduce deferred deduction remuneration attributable to that taxable year (but not applicable individual remuneration), the $25 loss reduces the $10,000 principal addition to B's account in 2017 for purposes of applying the section 162(m)(6) deduction limitation. With respect to the $10,000 principal addition to B's account in 2018, the account balance is $10,500 on December 31, 2018. Therefore, the $500 of earnings is attributable to Y's 2018 taxable year.

Example 5 (Nonaccount balance plan). (i) C is an applicable individual of corporation X for all relevant taxable years. On January 1, 2015, X grants C a vested right to a $100,000 payment on January 1, 2020.

(ii) Under the attribution method for nonaccount balance plans described in paragraph (d)(4) of this section, any increase (or decrease) in the present value of the future payment that C is entitled to receive under the nonaccount balance plan as of the last day of X's taxable year, over (or under) the present value of the future payment as of the last day of the preceding taxable year, increased by any payments made during the taxable year, is attributable to services provided by C in that taxable year. X determines the present value of the payment using an interest rate of five percent for all years, which, solely for purposes of this example, is assumed to be a reasonable actuarial assumption. The present value of $100,000 payable on January 1, 2020, determined using a five percent interest rate, is $82,300 as of December 31, 2015; $86,400 as of December 31, 2016; $90,700 as of December 31, 2017; and $95,200 as of December 31, 2018. Accordingly, $82,300 of deferred deduction remuneration is attributable to services performed by C in X's 2015 taxable year; $4,100 ($86,400 - $82,300) of deferred deduction remuneration is attributable to services performed by C in X's 2016 taxable year; $4,300 ($90,700 - $86,400) of deferred deduction remuneration is attributable to services performed by C in X's 2017 taxable year; $4,500 ($95,200 - $90,700) of deferred deduction remuneration is attributable to services performed by C in X's 2018 taxable year; and $4,800 ($100,000 - $95,200) of remuneration is attributable to services performed by C in X's 2019 taxable year.

Example 6 (Nonaccount balance plan). (i) D is an applicable individual of corporation W for all relevant taxable years. D begins employment with W on January 1, 2016. On December 31, 2020, D obtains the right to a payment from W equal to 10 percent of D's highest annual salary multiplied by D's years of service commencing on January 1 of the year following D's separation from service. In 2020, D has an annual salary of $375,000, which increases by $25,000 on January 1 of each subsequent calendar year. D separates from service with W on December 31, 2023, and W pays $360,000 to D on January 1, 2024. W determines the present value of amounts to be paid under the plan using an interest rate of five percent for all years, which, solely for purposes of this example, is assumed to be a reasonable actuarial assumption.

(ii) Under the attribution method for nonaccount balance plans described in paragraph (d)(4) of this section, the increase (or decrease) in the present value of the future payment to which D is entitled under the nonaccount balance plan as of the last day of W's taxable year, over (or under) the present value of the future payment as of the last day of the preceding taxable year, increased by any payments made during the taxable year, is attributable to services provided by D in that taxable year. W determines the present value of this payment using an interest rate of five percent for all years, which solely for purposes of this example, is assumed to be a reasonable actuarial assumption. As of December 31, 2021, D has the right to a payment of $240,000 on January 1, 2024 ($400,000 x 10% x 6 years of service). The present value as of December 31, 2021 of $240,000 payable on January 1, 2024 is $217,687. Therefore, $217,687 of deferred deduction remuneration is attributable to services performed by D in W's 2021 taxable year.

(iii) As of December 31, 2022, D has the right to a payment of $297,500 on January 1, 2023 ($425,000 x 10% x 7 years of service). The present value as of December 31, 2022 of $297,500 payable on January 1, 2023 is $283,333. Therefore, the deferred deduction remuneration attributable to services performed by D in W's 2022 taxable year is $65,546 ($283,333 - $217,680).

(iv) As of December 31, 2023, D has the right to a payment of $360,000 on January 1, 2024 ($450,000 x 10% x 8 years of service). The present value as of December 31, 2023 of $360,000 payable on January 1, 2024 is $360,000. Therefore, the deferred deduction remuneration attributable to services performed by D in W's 2023 taxable year is $76,767 ($360,000 - $283,333).

Example 7 (Stock option). (i) E is an applicable individual of corporation V for all relevant taxable years. On January 1, 2016, V grants E an option to purchase 100 shares of V common stock at an exercise price of $50 per share (the fair market value of V common stock on the date of grant). On December 31, 2017, E ceases to be a service provider of V or any member of V's aggregated group. On January 1, 2019, E resumes providing services for V and again becomes both a service provider and an applicable individual of V. On December 31, 2020, when the fair market value of V common stock is $196 per share, E exercises the stock option. The remuneration resulting from the stock option exercise is $14,600 (($196 - $50) x 100).

(ii) Pursuant to paragraph (d)(5)(i) of this section, the remuneration resulting from the exercise of a stock option is attributable to services performed by E over the period beginning on the date of grant of the stock option and ending on the date that the stock right is exercised, excluding any days on which E is not a service provider of V. Therefore, the $14,600 is attributed *pro rata* over the 1,460 days from January 1, 2016 to December 31, 2017 and from January 1, 2019 to December 31, 2020 (365 days per year for the 2016, 2017, 2019, and 2020 taxable years), so that $10 ($14,600 divided by 1,460) is attributed to each calendar day in this period, and $3,650 (365 days x $10) of remuneration is attributed to services performed by E in each of V's 2016, 2017, 2019, and 2020 taxable years.

Example 8 (Restricted stock). (i) F is an applicable individual of corporation U for all relevant taxable years. On January 1, 2017, U grants F 100 shares of restricted U common stock. Under the terms of the grant, the shares will be forfeited if F voluntarily terminates employment before December 31, 2019 (so that the shares are subject to a substantial risk of forfeiture through that date) and are nontransferable until the substantial risk of forfeiture lapses. F does not make an election under section 83(b) and continues in employment with U through December 31, 2019, at which time F's rights in the stock become substantially vested within the meaning of §1.83–3(b) and the fair market value of a share of the stock is $109.50. The deferred deduction remuneration resulting from the vesting of the restricted stock is $10,950 ($109.50 x 100).

(ii) Pursuant to paragraph (d)(5)(ii) of this section, the remuneration resulting from the vesting of restricted stock is attributable to services performed by F on a daily *pro rata* basis over the period, excluding any days on which F is not a service provider of U, beginning on the date F is granted the restricted stock and ending on the earliest of the date the substantial risk of forfeiture lapses or the date the restricted stock is transferred (or becomes transferable as defined in §1.83–3(d)). Therefore, the $10,950 of remuneration is attributed to services performed by F over the 1,095 days between January 1, 2017 and December 31, 2019 (365 days per year for the 2017, 2018, and 2019 taxable years), so that $10 ($10,950 divided by 1,095) is attributed to each calendar day in this period, and remuneration of $3,650 (365 days x $10) is attributed to services performed by F in each of U's 2017, 2018, and 2019 taxable years.

Example 9 (Restricted stock units (RSUs)). (i) G is an applicable individual of corporation T for all relevant taxable years. On January 1, 2018, T grants G 100 RSUs. Under the terms of the grant, T will pay G an amount on December 31, 2020 equal to the fair market value of 100 shares of T common stock on that date, but only if G continues to provide substantial services to T (so that the RSU is subject to a substantial risk of forfeiture) through December 31, 2020. G remains employed by T through December 31, 2020, at which time the fair market value of a share of the stock is $219, and T pays G $21,900 ($219 x 100).

(ii) Pursuant to paragraph (d)(5)(iii) of this section, remuneration from the payment under the RSUs is attributed on a daily *pro rata* basis to services performed by G over the period beginning on the date the RSUs are granted and ending on the date the remuneration is paid or made available, excluding any days on which G is not a service provider of T. Therefore, the $21,900 in remuneration is attributed over the 1,095 days beginning on January 1, 2018 and ending on December 31, 2020 (365 days per year for the 2018, 2019, and 2020 taxable years), so that $20 ($21,900 divided by 1,095) is attributed to each calendar day in this period, and $7,300 (365 days x $20) is attributed to service performed by G in each of T's 2018, 2019, and 2020 taxable years.

Example 10 (Involuntary separation pay). (i) H is an applicable individual of corporation S. On January 1, 2015, H and S enter into an employment contract providing that S will make two payments of $150,000 each to H if H has an involuntary separation from service. Under the terms of the contract, the first payment is due on January 1 following the involuntary separation from service, and the second payment is due on January 1 of the following year. On December 31, 2016, H has an involuntary separation from service. S pays H $150,000 on January 1, 2017 and $150,000 on January 1, 2018.

(ii) Pursuant to paragraph (d)(6) of this section, involuntary separation pay may be attributed to services performed by H in the taxable year of S in which the involuntary separation from service occurs. Alternatively, involuntary separation pay may be attributed to services performed by H on a daily *pro rata* basis beginning on the date H obtains a right to the involuntary separation pay and ending on the date of the involuntary separation from service. The entire $300,000 amount, including both $150,000 payments, must be attributed using the same method. Therefore, the entire $300,000 amount (comprised of two $150,000 payments) may be attributed to services performed by H in S's 2016 taxable year, which is the taxable year in which the involuntary separation from service occurs. Alternatively, the two $150,000 payments may be attributable to the period beginning on January 1, 2015 and ending December 31, 2016, so that $410.96 ($300,000 / (365 x 2)) is attributed to each day of S's 2015 and 2016 taxable years, and $150,000 ($410.96 x 365) is attributed to services performed by H in each of S's 2015 and 2016 taxable years.

Example 11 (Reimbursement after termination of services). (i) I is an applicable individual of corporation R. On January 1, 2018, I enters into an agreement with R under which R will reimburse I's country club dues for two years following I's separation from service. On December 31, 2020, I ceases to be a service provider of R. I pays $50,000 in country club dues on January 1, 2021 and $50,000 on January 2, 2022. Pursuant to the agreement, R reimburses I $50,000 for the country club dues in 2021 and $50,000 in 2022.

(ii) Pursuant to paragraph (d)(7) of this section, remuneration provided in the form of a reimbursement or in-kind benefit after I ceases to be a service provider of R is attributed to services provided by I in R's taxable year in which I ceases to be an officer, director, or employee of R and ceases performing services for, or on behalf of, R. Therefore, $100,000 is attributed to services performed in R's 2020 taxable year.

(10) *Certain deferred deduction remuneration subject to a substantial risk of forfeiture.* If remuneration is attributable in accordance with paragraph (d)(2) (legally binding right), (d)(3) (account balance plan), or (d)(4) (nonaccount balance plan) of this section to services performed in a period that includes two or more taxable years of a covered health insurance provider during which the remuneration is subject to a substantial risk of forfeiture, that remuneration must be attributed using a two-step process. First, the remuneration must be attributed to the taxable years of the covered health insurance provider in accordance with paragraph (d)(2), (3), or (4) of this section, as applicable. Second, the remuneration attributed to the period during which the remuneration is subject to a substantial risk of forfeiture (the vesting period) must be reattributed on a daily *pro rata* basis over that period beginning on the date that the applicable individual obtains a legally binding right to the remuneration and ending on the date that the substantial risk of forfeiture lapses. If a vesting period ends on a day other than the last day of the covered health insurance provider's taxable year, the remuneration attributable to that taxable year under the first step of the attribution process is divided between the portion of the taxable year that includes the vesting period and the portion of the taxable year that does not include the vesting period. The amount attributed to the portion of the taxable year that includes the vesting period is equal to the total amount of remuneration that would be attributable to the taxable year under the first step of the attribution process, multiplied by a fraction, the numerator of which is the number of days during the taxable year that the amount is subject to a substantial risk of forfeiture and the denominator of which is the number of days in such taxable year. The remaining amount is attributed to the portion of the taxable year that does not include the vesting period and, therefore, is not reattributed under the second step of the attribution process. For purposes of this section, the date on which a substantial risk of forfeiture lapses is the date on which the substantial risk of forfeiture lapses for any reason, including the death, disability, or involuntary termination of employment of the applicable individual, or the discretionary action of a covered health insurance provider or any other person.

(11) *Examples.* The following examples illustrate the principles of paragraph (d)(10) of this section. For purposes of these examples, each corporation has a taxable year that is the calendar year and is a covered health insurance provider for all relevant taxable years; deferred deduction remuneration is otherwise deductible in the taxable year in which it is paid, and amounts payable under nonaccount balance plans are not forfeitable upon the death of the applicable individual.

Example 1 (Account balance plan subject to a substantial risk of forfeiture using the standard attribution method). (i) J is an applicable individual of corporation Q for all relevant taxable years. On January 1, 2016, J begins participating in a nonqualified deferred compensation plan that is an account balance plan. Under the terms of the plan, Q will pay J's account balance on January 1, 2021, but only if J continues to provide substantial services to Q through December 31, 2018 (so that the amount credited to J's account is subject to a substantial risk of forfeiture through that date). Q credits $10,000 to J's account annually for five years on January 1 of each year beginning on January 1, 2016. The account earns interest at a fixed rate of five percent per year, compounded annually, which solely for the purposes of this example, is assumed to be a reasonable rate of interest. Therefore, J's account balance is $10,500 ($10,000 + ($10,000 x 5%)) on December 31, 2016; $21,525 ($10,500 + $10,000 + ($20,500 x 5%)) on December 31, 2017; $33,101 ($21,525 + $10,000 + ($31,525 x 5%)) on December 31, 2018; $45,256 ($33,101 + $10,000 + ($43,101 x 5%)) on December 31, 2019; and $58,019 ($45,256 + $10,000 + ($55,256 x 5%)) on December 31, 2020. Q attributes increases and decreases in account balances under the plan using the standard attribution method described in paragraph (d)(3)(i) of this section.

(ii) Under the standard attribution method for account balance plans described in paragraph (d)(3)(i) of this section, any increases in J's account balance as of the last day of Q's taxable year over the account balance as of the last day of the immediately preceding taxable year, increased by any payments made during the taxable year, is attributable to services provided by J in that taxable year. Accordingly, $10,500 of deferred deduction remuneration is initially attributable to services performed by J in Q's 2016 taxable year (the difference between the $10,500 account balance on December 31, 2016 and the zero account balance on December 31, 2015); $11,025 of deferred deduction remuneration is initially attributable to services performed by J in Q's 2017 taxable year (the difference between the $21,525 account balance on December 31, 2017 and the $10,500 account balance on December 31, 2016); $11,576 of deferred deduction remuneration is initially attributable to services performed by J in Q's 2018 taxable year (the difference between the $33,101 account balance on December 31, 2018 and the $21,525 account balance on December 31, 2017); $12,155 of deferred deduction remuneration is attributable to services performed by

J in Q's 2019 taxable year (the difference between the $45,256 account balance on December 31, 2019 and the $33,101 account balance on December 31, 2018); and $12,763 of deferred deduction remuneration is attributable to services performed by J in Q's 2020 taxable year (the difference between the $58,019 account balance on December 31, 2020 and the $45,256 account balance on December 31, 2018).

(iii) Under the attribution method described in paragraph (d)(10) of this section, deferred deduction remuneration that is attributable to services performed in a period that includes two or more taxable years of Q during which the deferred deduction remuneration is subject to a substantial risk of forfeiture must be reattributed on a daily *pro rata* basis over the period beginning on the date that J obtains a legally binding right to the remuneration and ending on the date that the substantial risk of forfeiture lapses. Therefore, $33,101 ($10,500 + $11,025 + $11,576) is reattributed on a daily *pro rata* basis over the period beginning on January 1, 2016, and ending on December 31, 2018, and $11,034 is attributed to each of Q's 2016, 2017, and 2018 taxable years.

Example 2 (*Account balance plan subject to a substantial risk of forfeiture using the alternative attribution method).* (i) The facts are the same as in *Example 1*, except that Q allocates earnings and losses using the alternative attribution method described in paragraph (d)(3)(ii) of this section.

(ii) Under the alternative attribution method for account balance plans described in paragraph (d)(3)(ii) of this section, earnings and losses on a principal addition are attributed to the same disqualified taxable year of Q to which the principal addition is attributed. Therefore, the amount initially attributable to Q's 2016 taxable year is $12,763 (the $10,000 principal addition in 2016 at five percent interest for five years); the amount initially attributable to Q's 2017 taxable year is $12,155 (the $10,000 principal addition in 2017 at five percent interest for four years); the amount initially attributable to Q's 2018 taxable year is $11,576 (the $10,000 principal addition in 2018 at five percent interest for three years); the amount attributable to Q's 2019 taxable year is $11,025 (the $10,000 principal addition in 2019 at five percent interest for two years), and the amount attributable to Q's 2020 taxable year is $10,500 (the $10,000 principal addition in 2020 at five percent interest for one year).

(iii) Under the attribution method described in paragraph (d)(10) of this section, deferred deduction remuneration that is attributable to two or more taxable years of Q during which the deferred deduction remuneration is subject to a substantial risk of forfeiture must be reattributed on a daily *pro rata* basis to that period beginning on the date that J obtains a legally binding right to the remuneration and ending on the date that the substantial risk of forfeiture lapses. Therefore, $36,494 ($12,763 + $12,155 + $11,576) is reattributed on a daily *pro rata* basis over the period beginning on January 1, 2016, and ending on December 31, 2018, and $12,165 is attributed to each of Q's 2016, 2017, and 2018 taxable years.

Example 3 (Nonaccount balance plan subject to a substantial risk of forfeiture). (i) K is an applicable individual of corporation J for all relevant taxable years. K begins employment with J on January 1, 2016 and begins participating in a nonqualified deferred compensation plan that is a defined benefit plan. Under the terms of the plan, J will pay K an amount equal to ten percent of K's highest annual salary multiplied by K's years of service as of K's separation from service, but only if K remains employed through December 31, 2020 (so that the right to the remuneration is subject to a substantial risk of forfeiture through that date). In 2016, K has annual salary of $275,000, which increases by $25,000 on January 1 of each subsequent calendar year. K has a separation from service from J on December 31, 2025, and J pays $500,000 to K on January 1, 2026 pursuant to the terms of the plan. J determines the present value of amounts to be paid under the plan using an interest rate of five percent for all years, which, solely for purposes of this example, is assumed to be a reasonable actuarial assumption.

(ii) As of December 31, 2016, K has a right to a payment of $27,500 on January 1, 2026 ($275,000 x 10% x 1 years of service). The present value as of December 31, 2021, of a $27,500 payment to be made on January 1, 2026, is $17,727. Therefore, the remuneration initially attributable to services performed by K in J's 2021 taxable year is $17,727 ($17,727 - $0).

(iii) As of December 31, 2017, K has a right to a payment of $60,000 on January 1, 2026 ($300,000 x 10% x 2 years of service). The present value as of December 31, 2021, of a $60,000 payment to be made on January 1, 2026, is $40,610. Therefore, the remuneration initially attributable to services performed by K in J's 2021 taxable year is $22,884 ($40,610 - $17,727).

(iv) As of December 31, 2018, K has a right to a payment of $97,500 on January 1, 2026 ($325,000 x 10% x 3 years of service). The present value as of December 31, 2021, of a $97,500 payment to be made on January 1, 2026, is $69,291. Therefore, the remuneration initially attributable to services performed by K in J's 2021 taxable year is $28,681 ($69,291 - $40,610).

(v) As of December 31, 2019, K has a right to a payment of $140,000 on January 1, 2026 ($350,000 x 10% x 4 years of service). The present value as of December 31, 2021, of a $140,000 payment to be made on January 1, 2026, is $104,470. Therefore, the remuneration initially attributable to services performed by K in J's 2021 taxable year is $35,179 ($104,470 - $69,291).

(vi) As of December 31, 2020, K has a right to a payment of $187,500 on January 1, 2026 ($375,000 x 10% x 5 years of service). The present value as of December 31, 2021, of a $187,500 payment to be made on January 1, 2026, is $146,911. Therefore, the remuneration initially attributable to services performed by K in J's 2021 taxable year is $42,441 ($146,911 - $104,470).

(vii) As of December 31, 2021, K has a right to a payment of $240,000 on January 1, 2026 ($400,000 x 10% x 6 years of service). The present value as of December 31, 2021, of a $240,000 payment to be made on January 1, 2026, is $197,449. Therefore, the remuneration attributable to services performed by K in J's 2021 taxable year is $50,537 ($197,449 - $146,911).

(viii) As of December 31, 2022, K has a right to a $297,500 payment on January 1, 2026 ($425,000 x 10% x 7 years of service). The present value as of December 31, 2022, of a $297,500 payment to be made on January 1, 2026, is $256,992. Therefore, the remuneration attributable to services performed by K in J's 2022 taxable year is $59,543 ($256,992 - $197,449).

(ix) As of December 31, 2023, K has a right to a $360,000 payment on January 1, 2026 ($450,000 x 10% x 8 years of service). The present value as of December 31, 2023 of a $360,000 payment to be made on January 1, 2026 is $326,532. Therefore, the remuneration attributable to services performed by K in J's 2023 taxable year is $69,539 ($326,531 - $256,992).

(x) As of December 31, 2024, K has a right to a $427,500 payment on January 1, 2026 ($475,000 x 10% x 9 years of service). The present value as of December 31, 2024 of a $427,500 payment to be made on January 1, 2026 is $407,143. Therefore, the remuneration attributable to services performed by K in J's 2024 taxable year is $80,612 ($407,143 - $326,531).

(xi) As of December 31, 2025, K has a right to a $500,000 payment on January 1, 2026 ($500,000 x 10% x 10 years of service). The present value as of December 31, 2025 of a $500,000 payment to be made on January 1, 2026 is $500,000. Therefore, the applicable individual remuneration attributable to services performed by K in J's 2025 taxable year is $92,857 ($500,000 - $407,143).

(xii) Under the attribution method described in paragraph (d)(10) of this section, deferred deduction remuneration that is attributable to two or more taxable years of a covered health insurance provider during which the deferred deduction remuneration is subject to a substantial risk of forfeiture must be reattributed on a daily *pro rata* basis to that period beginning on the date that the applicable individual obtains a legally binding right to the remuneration and ending on the date that the substantial risk of forfeiture lapses. Therefore, $146,911 ($17,727 + $22,884 + $28,681 + $35,179 + $42,441) is reattributed on a daily *pro rata* basis over the period beginning on January 1, 2016, and ending on December 31, 2020, and, accordingly, $29,382 (($146,911 / (5 x 365)) x 365) is attributed to services performed by K in each of L's 2016, 2017, 2018, 2019, and 2020 taxable years.

(e) *Application of the deduction limitation*—(1) *To aggregate amounts*. The $500,000 deduction limitation is applied to the aggregate amount of applicable individual remuneration and deferred deduction remuneration attributable to services performed by an applicable individual in a disqualified taxable year. The aggregate amount of applicable individual remuneration and deferred deduction remuneration attributable to services performed by an applicable individual in a disqualified taxable year that exceeds the $500,000 deduction limitation is not allowed as a deduction in any taxable year. Therefore, for example, if an applicable individual has $500,000 or more of applicable individual remuneration attributable to services provided to a covered health insurance provider in a disqualified taxable year, the amount of that applicable individual

remuneration that exceeds $500,000 is not deductible in any taxable year, and no deferred deduction remuneration attributable to services performed by the applicable individual in that disqualified taxable year is deductible in any taxable year. However, if an applicable individual has applicable individual remuneration for a disqualified taxable year that is less than $500,000 and deferred deduction remuneration attributable to services performed in the same disqualified taxable year that, when combined with the applicable individual remuneration for the year, is greater than $500,000, all of the applicable individual remuneration is deductible in that disqualified taxable year, but the amount of deferred deduction remuneration that is deductible in future taxable years is limited to the excess of $500,000 over the amount of the applicable individual remuneration for that year.

(2) *Order of application and calculation of deduction limitation*—(i) *In general*. The deduction limitation with respect to any applicable individual for any disqualified taxable year is applied to applicable individual remuneration and deferred deduction remuneration attributable to services performed by that applicable individual in that disqualified taxable year at the time that the remuneration becomes otherwise deductible, and each time the deduction limitation is applied to an amount that is otherwise deductible, the deduction limitation is reduced (but not below zero) by the amount against which it is applied. Accordingly, the deduction limitation is applied first to an applicable individual's applicable individual remuneration attributable to services performed in a disqualified taxable year and is reduced (but not below zero) by the amount of the applicable individual remuneration against which it is applied. If the applicable individual also has an amount of deferred deduction remuneration attributable to services performed in that disqualified taxable year that becomes otherwise deductible in a subsequent taxable year, the deduction limitation, as reduced, is applied to that amount of deferred deduction remuneration in the first taxable year in which it becomes otherwise deductible. The deduction limitation is then further reduced (but not below zero) by the amount of the deferred deduction remuneration against which it is applied. If the applicable individual has an additional amount of deferred deduction remuneration attributable to services performed in the original disqualified taxable year that becomes otherwise deductible in a subsequent taxable year, the deduction limitation, as further reduced, is applied to that amount of deferred deduction remuneration in the taxable year in which it is otherwise deductible. This process continues for future taxable years in which deferred deduction remuneration attributable to services performed by the applicable individual in the original disqualified taxable year is otherwise deductible. No deduction is allowed in any taxable year for any applicable individual remuneration or deferred deduction remuneration attributable to services performed by an applicable individual in a disqualified taxable year to the extent that it exceeds the deduction limitation (as reduced, if applicable) for that disqualified taxable year at the time the deduction limitation is applied to the remuneration.

(ii) *Application to payments*—(A) *In general*. Any payment of deferred deduction remuneration may include remuneration that is attributable to services performed by an applicable individual in one or more earlier taxable years of a covered health insurance provider pursuant to paragraphs (d)(2) through (d)(8) and paragraph (d)(10) of this section. In that case, a separate deduction limitation applies to each portion of the payment that is attributed to services performed in a different disqualified taxable year. Any portion of a payment that is attributed to a taxable year that is a disqualified taxable year is deductible only to the extent that it does not exceed the deduction limit that applies with respect to the applicable individual for that disqualified taxable year, as reduced by the amount, if any, of applicable individual remuneration and deferred deduction remuneration attributable to services performed in that disqualified taxable year that was deductible in an earlier taxable year.

(B) *Application to series of payments*. Under the rule described in paragraph (d)(1)(ii) of this section, amounts attributable to services performed by an applicable individual pursuant to paragraph (d)(3) or (4) of this section must be attributed to services performed by the applicable individual in the earliest year that the amount could be attributable under paragraph (d)(3) of (4) of this section, as applicable. Any portion of a payment that is attributed to services performed in a taxable year is treated as paid for all purposes under this section, including the calculation of future earnings and the attribution of other remuneration.

(3) *Examples*. The following examples illustrate the rules of paragraphs (e)(1) and (e)(2) of this section. For purposes of these examples, each corporation has a taxable year that is the calendar year and is a covered health insurance provider for all relevant taxable years; deferred deduction remuneration is otherwise deductible in the taxable year in which it is paid, and amounts payable under nonaccount balance plans are not forfeitable upon the death of the applicable individual.

Example 1 (Lump-sum payment of deferred deduction remuneration attributable to a single taxable year). (i) L is an applicable individual of corporation O. During O's 2015 taxable year, O pays L $550,000 in salary, which is applicable individual remuneration, and grants L a right to $50,000 of deferred deduction remuneration payable upon L's separation from service from O. L has a separation from service in 2020, at which time O pays L the $50,000 of deferred deduction remuneration attributable to services performed by L in O's 2015 taxable year.

(ii) The $500,000 deduction limitation for 2015 is applied first to L's $550,000 of applicable individual remuneration for 2015. Because the $550,000 otherwise deductible by O in 2015 is greater than the deduction limitation, O may deduct only $500,000 of the applicable individual remuneration for 2015, and $50,000 of the $550,000 of applicable individual remuneration is not deductible for any taxable year. The deduction limitation for remuneration attributable to services provided by L in O's 2015 taxable year is then reduced to zero. Because the $50,000 in deferred deduction remuneration attributable to services performed by L in 2015 exceeds the reduced deduction limitation of zero, that $50,000 is not deductible for any taxable year.

Example 2 (Installment payments of deferred deduction remuneration attributable to a single taxable year). (i) M is an applicable individual of corporation N. During N's 2016 taxable year, N pays M $300,000 in salary, which is applicable individual remuneration, and grants M a right to $220,000 of deferred deduction remuneration payable on a fixed schedule beginning upon M's separation from service. The $220,000 is attributable to services provided by M in N's 2016 taxable year. M has a separation from service in 2020. In 2020, N pays M $400,000 in salary, which is applicable individual remuneration, and also pays M $120,000 of deferred deduction remuneration that is attributable to services performed in N's 2016 taxable year. In 2021, N pays M the remaining $100,000 of deferred deduction remuneration attributable to services performed by M in N's 2016 taxable year.

(ii) The $500,000 deduction limitation for 2016 is applied first to M's $300,000 of applicable individual remuneration for 2016. Because the deduction limitation is greater than the applicable individual remuneration, N may deduct the entire $300,000

of applicable individual remuneration paid in 2016. The $500,000 deduction limitation is then reduced to $200,000 by the amount of the applicable individual remuneration ($500,000 - $300,000). The reduced deduction limitation is applied to M's $120,000 of deferred deduction remuneration attributable to services performed by M in N's 2016 taxable year that is paid in 2020. Because the reduced deduction limitation of $200,000 is greater than the $120,000 of deferred deduction remuneration, for N's 2020 taxable year, N may deduct the entire $120,000 of deferred deduction remuneration paid in 2020. The $200,000 deduction limitation is reduced to $80,000 by the $120,000 in deferred deduction remuneration against which it was applied ($200,000 - $120,000). The reduced deduction limitation of $80,000 is then applied to the remaining $100,000 payment of deferred deduction remuneration attributable to services performed by M in N's 2016 taxable year. Because the $100,000 in deferred deduction remuneration otherwise deductible by N for 2021 exceeds the reduced deduction limitation of $80,000, N may deduct only $80,000 of the deferred deduction remuneration for the 2021 taxable year, and $20,000 of the $100,000 payment is not deductible by N for any taxable year.

Example 3 (Lump-sum payment attributable to multiple years from an account balance plan using the standard attribution method). (i) N is an applicable individual of corporation M for all relevant taxable years. On January 1, 2013, N begins participating in a nonqualified deferred compensation plan sponsored by M that is an account balance plan. Under the plan, all amounts are fully vested at all times. The balances in N's account (including principal additions and earnings) are $50,000 on December 31, 2013, $100,000 on December 31, 2014, and $200,000 on December 2015. N's applicable individual remuneration from M is $425,000 for 2013, $450,000 for 2014, and $500,000 for 2015. On January 1, 2016, in accordance with the plan terms, M pays $200,000 to N, which is a payment of N's entire account balance under the plan.

(ii) To determine the extent to which M is entitled to a deduction for any portion of the $200,000 payment under the plan, the payment must first be attributed to services performed by N in M's taxable years in accordance with the attribution rules set forth in paragraph (d) of this section. Under the standard attribution method for account balance plans in paragraph (d)(3)(i) of this section, remuneration under an account balance plan is attributed to services performed by N in M's taxable years in an amount equal to the increase (or decrease) in the account balance as of the last day of M's taxable year over the account balance as of the last day of the immediately preceding taxable year, increased by any payments made during that year. Therefore, N's remuneration under the account balance plan is attributed to services performed by N in M's taxable years as follows: $50,000 ($50,000 - $0) in 2013, $50,000 ($100,000 - $50,000) in 2014, and $100,000 ($200,000 - $100,000) in 2015.

(iii) Under the rules in paragraphs (d)(1)(ii) and (e)(2)(ii)(B) of this section, the January 1, 2016 payment of $200,000 is deemed a payment of remuneration attributed to services performed by N in the earliest year that the amount could be attributed under paragraph (d)(3)(i) of this section. M's first taxable year to which any portion of the payment could be attributed is M's 2013 taxable year. Accordingly, $50,000 of the $200,000 payment is attributed to services performed by N in M's 2013 taxable year. M's next earliest taxable year to which any portion of the payment could be attributed is M's 2014 taxable year. Accordingly, $50,000 of the $200,000 payment is attributed to services performed by N in M's 2014 taxable year. M's next earliest disqualified taxable year to which any portion of the payment could be attributed is M's 2015 taxable year. Accordingly, the remaining $100,000 of the $200,000 payment is attributed to services performed by N in M's 2015 taxable year.

(iv) The portion of the deferred deduction remuneration attributed to services performed in a disqualified taxable year under paragraph (d) of this section that exceeds the deduction limitation for that disqualified taxable year, as reduced through the date of payment, is not deductible in any taxable year. For M's 2013 taxable year, the deduction limitation is reduced to $75,000 by the $425,000 of applicable individual remuneration for that year. Because $50,000 does not exceed that reduced deduction limitation, all $50,000 of the deferred deduction remuneration attributed to services performed by N in M's 2013 taxable year is deductible for 2016, the year of payment. The deduction limitation for remuneration attributable to services performed by N that are attributable to 2013 is then reduced to $25,000, and this reduced limitation is applied to any future payment of deferred deduction remuneration attributable to services performed by N in 2013. For M's 2014 taxable year, the deduction limitation is reduced to $50,000 by N's $450,000 of applicable individual remuneration for that year. Because $50,000 does not exceed that reduced deduction limitation, all $50,000 of the deferred deduction remuneration attributed to M's 2014 taxable year is deductible for 2016, the year of payment. The deduction limitation for remuneration attributable to services performed by N in 2014 is then reduced to zero, and this reduced limitation is applied to any future payment of deferred deduction remuneration attributable to services performed by N in 2014. For M's 2015 taxable year, the deduction limitation is reduced to zero during 2015 by N's $500,000 of applicable individual remuneration for that year. Because $100,000 exceeds the reduced limit of zero, the $100,000 of the deferred deduction remuneration attributed to services performed by N in M's 2015 taxable year is not deductible for the year of payment (or any other taxable year). As a result, $100,000 of the $200,000 payment ($50,000 + $50,000 + $0) is deductible by M for M's 2016 taxable year, and the remaining $100,000 is not deductible by M for any taxable year.

Example 4 (Installment payments attributable to multiple taxable years from an account balance plan using the standard attribution method). (i) O is an applicable individual of corporation L for all relevant taxable years. On January 1, 2016, O begins participating in a nonqualified deferred compensation plan sponsored by L that is an account balance plan. Under the plan, all amounts are fully vested at all times. L credits principal additions to O's account each year, and credits earnings based on a predetermined actual investment within the meaning of §31.3121(v)(2)–1(d)(2)(i)(B). The balances in O's account (including principal additions and earnings) are $100,000 on December 31, 2016, $250,000 on December 31, 2017, and $450,000 on December 2018. O's applicable individual remuneration from L is $500,000 for 2016, $300,000 for 2017, and $450,000 for 2018. On January 1, 2019, L pays O $400,000 in accordance with the plan terms. As a result of the payment, O's remaining account balance is $50,000 ($450,000 - $400,000). On December 31, 2019, O's account balance is increased to $200,000 by additional credits made during the year. O's applicable remuneration from L is $200,000 for 2019. On January 1, 2020, L pays O $200,000 in accordance with the plan terms.

(ii) To determine the extent to which L is entitled to a deduction for any portion of either of the payments under the plan, O's payments under the plan must first be attributed to services performed by O in L's taxable years in accordance with the attribution rules set forth in paragraph (d) of this section. Under the standard attribution method for account balance plans described in paragraph (d)(3)(i) of this section, remuneration is attributed to services performed by O in L's taxable years in an amount equal to the increase in O's account balance as of the last day of L's taxable year over the account balance as of the last day of the immediately preceding taxable year, increased by any payments made during that year. Therefore, O's deferred deduction remuneration under the plan is attributed to L's taxable years as follows: $100,000 ($100,000 - $0) in 2016, $150,000 ($250,000 - $100,000) in 2017, $200,000 ($450,000 - $250,000) in 2018, and $150,000 ($200,000 - $450,000 + $400,000) in 2019.

(iii) Under the rules in paragraphs (d)(1)(ii) and (e)(2)(ii)(B) of this section, the January 1, 2019 payment of $400,000 is deemed a payment of remuneration attributed to services performed by O in the earliest taxable year that the amount could be attributed under paragraph (d)(3)(i) of this section. L's first taxable year to which any portion of the payment could be attributed is L's 2016 taxable year. Accordingly, $100,000 of the $400,000 payment is attributed to services performed by O in L's 2016 taxable year. L's next earliest taxable year to which any portion of the payment could be attributed is L's 2017 taxable year. Accordingly, $150,000 of the $400,000 payment is attributed to services performed by O in L's 2017 taxable year. L's next earliest taxable year to which any portion of the payment could be attributed is L's 2018 taxable year. Accordingly, the remaining $150,000 of the $400,000 payment is attributed to services performed by O in L's 2018 taxable year. Because the portion of the $400,000 payment attributed to L's 2018 taxable year is less than the total deferred deduction remuneration attributed to L's 2018 taxable year, the excess deferred deduction remuneration ($50,000) is treated as paid in a subsequent taxable year.

(iv) The portion of the deferred deduction remuneration attributed to services performed in a disqualified taxable year under paragraph (d) of this section that exceeds the deduction limitation for that disqualified taxable year, as reduced, is not deductible for any taxable year. For L's 2016 taxable year, the deduction limitation is reduced to zero by the $500,000 of applicable individual remuneration for that year. Because $100,000 exceeds the reduced deduction limitation of zero, the $100,000 of the deferred deduction remuneration is not deductible for L's 2019 taxable year, the year of payment, or any other taxable

year. For L's 2017 taxable year, the deduction limitation is reduced to $200,000 by the $300,000 of applicable individual remuneration for that year. Because $150,000 does not exceed that reduced deduction limitation, the $150,000 of the deferred deduction remuneration is deductible for 2019, the year of payment. The deduction limitation for remuneration attributable to services performed by O in 2017 is then reduced to $50,000, and this reduced limitation is applied to any future payment of deferred deduction remuneration attributable to services performed by O in 2017. For L's 2018 taxable year, the deduction limitation is reduced to $50,000 by the $450,000 of applicable individual remuneration for that year. Because the $150,000 of deferred deduction remuneration exceeds the reduced deduction limitation of $50,000, $100,000 of the $150,000 attributable to services performed by O in L's 2018 taxable year is not deductible for L's 2019 taxable year, the year of payment, or any other taxable year. As a result, $200,000 of the $400,000 payment ($0 + $150,000 + $50,000) is deductible by L for L's 2019 taxable year, and the remaining $200,000 is not deductible by L for any taxable year.

(v) Applying the rules in paragraphs (d)(1)(ii) and (e)(2)(ii)(B) of this section to the January 1, 2020 payment of $200,000, the payment is deemed a payment of deferred deduction remuneration attributed to services performed by O in the earliest taxable year that the amount could be attributed under paragraph (d)(3)(i) of this section. L's first taxable year to which any portion of the payment could be attributed is L's 2018 taxable year because all of the deferred deduction remuneration attributed to earlier taxable years was deemed paid as part of the January 1, 2019 payment. Accordingly, $50,000 of the $200,000 payment is attributed to services performed by O in L's 2018 taxable year (because the remaining portion of the deferred deduction remuneration under the plan originally attributed to services performed by O in L's 2018 taxable year was deemed paid as part of the January 1, 2019 payment). L's next earliest taxable year to which any portion of the payment is attributed is L's 2019 taxable year. Accordingly, $150,000 of the $200,000 payment is attributed to services performed by O in L's 2019 taxable year.

(vi) The portion of the deferred deduction remuneration attributed to a disqualified taxable year under paragraph (d) of this section that exceeds the deduction limitation for that disqualified taxable year, as reduced, is not deductible for any taxable year. For L's 2018 taxable year, the deductible limitation is reduced to zero by the $450,000 of applicable individual remuneration for that year and the $50,000 of deferred deduction remuneration deducted in 2019. Because $50,000 exceeds the reduced deduction limitation of zero, $50,000 of the deferred deduction remuneration is not deductible for L's 2020 taxable year, the year of payment, or any other taxable year. For L's 2019 taxable year, the deduction limitation is not reduced because there is no applicable individual remuneration for that year. Because $150,000 does not exceed the unreduced $500,000 limitation, the $150,000 of the deferred deduction remuneration is deductible for L's 2020 taxable year, the year of payment. As a result, $150,000 of the $200,000 payment ($0 + $150,000) is deductible by L for L's 2020 taxable year, and the remaining $50,000 is not deductible by L for any taxable year.

Example 5 (Installment payments attributable to multiple taxable years from an account balance plan using the alternative attribution method for account balance plans). (i) The facts are the same as set forth in *Example 4*, paragraph (i), except as set forth in this paragraph (i). L uses the alternative method for attributing remuneration from an account balance plan. Principal additions under the plan are $50,000 in 2016 and 2017, $100,000 in 2018, and $125,000 in 2019. As of the January 1, 2019 initial payment date, earnings on the 2016, 2017, and 2018 are $125,000, $75,000, and $50,000 respectively.

(ii) To determine the extent to which L is entitled to a deduction for any portion of either payment under the plan, the payments to O under the plan must first be attributed to services performed by O in F's taxable years in accordance with the attribution rules set forth in paragraph (d) of this section. Under the alternative attribution method for account balance plans in paragraph (d)(3)(ii) of this section, the amount of remuneration under an account balance plan attributed to services performed in a taxable year is equal to the sum of the principal additions credited to the plan for that taxable year plus (or minus) the earnings (or losses) credited on those principal additions.

(iii) Under the rule in paragraphs (d)(1)(ii) and (e)(2)(ii)(B) of this section, the $400,000 payment on January 1, 2019, is deemed to constitute a payment of remuneration attributed to services performed by O in the earliest taxable year that the amount could be attributed under paragraph (d)(3)(ii) of this section. L's first taxable year to which any portion of the payment could be attributed is L's 2016 taxable year. Accordingly, $175,000 of the $400,000 payment is attributed to services performed by O in L's 2016 taxable year. The next earliest taxable year of L to which any portion of the payment could be attributed is L's 2017 taxable year. Accordingly, $125,000 of the $400,000 payment is attributed to services performed by O in L's 2017 taxable year. L's next earliest taxable year to which any portion of the payment could be attributed is L's 2018 taxable year. Accordingly, the remaining $100,000 of the $400,000 payment is attributed to services performed by O in L's 2018 taxable year. Because the portion of the $400,000 payment attributed to L's 2018 taxable year is less than the total deferred deduction remuneration attributable to services performed by O in L's 2018 taxable year, the excess deferred deduction remuneration ($50,000) is treated as paid in a subsequent taxable year.

(iv) The portion of the deferred deduction remuneration attributable to services performed in a disqualified taxable year under paragraph (d) of this section that exceeds the deduction limitation for that disqualified taxable year, as reduced, is not deductible for any taxable year. For L's 2016 taxable year, the deduction limitation is reduced to zero by the $500,000 of applicable individual remuneration for that year. Because $175,000 exceeds the reduced deduction limitation of zero, the $175,000 is not deductible for L's 2019 taxable year, the year of payment, or any other taxable year. For L's 2017 taxable year, the deduction limitation is reduced to $200,000 by the $300,000 of applicable individual remuneration for that year. Because $125,000 does not exceed the reduced deduction limitation, the $125,000 payment is deductible for 2019. For L's 2018 taxable year, the deduction limitation is reduced to $50,000 by the $450,000 of applicable individual remuneration for that year. Because $100,000 exceeds the reduced limitation of $50,000, $50,000 of the $100,000 attributable to L's 2018 taxable year is not deductible for 2019, the year of payment, or any other taxable year. As a result, $175,000 of the $400,000 payment ($0 + $125,000 + $50,000) is deductible by L for L's 2019 taxable year, and the remaining $225,000 is not deductible by L for any taxable year.

(v) Earnings through January 1, 2020 on the excess deferred deduction remuneration attributable to L's 2018 taxable year ($50,000) that was not paid as part of the January 1, 2019 payment are $10,000. Earnings through January 1, 2020 on the $100,000 in principal credited to O's account on January 1, 2019 are $15,000. Therefore, as of January 1, 2020, O's remaining deferred deduction remuneration under the plan is attributed to L's taxable years as follows: $60,000 ($50,000 + $10,000) to 2018 and $140,000 ($125,000 + $15,000) to 2019. Applying the rules in paragraphs (d)(1)(ii) and (e)(2)(ii)(B) to the January 1, 2020 payment of $200,000, the payment is deemed a payment of deferred deduction remuneration attributed to services performed by O in the earliest taxable year that the amount could be attributed under paragraph (d)(3)(ii) of this section. L's first taxable year to which any portion of the payment could be attributed is L's 2018 taxable year because all of the deferred deduction remuneration attributed to earlier taxable years was deemed paid as part of the January 1, 2019 payment. Accordingly, $60,000 of the $200,000 payment is attributed to services performed by O in L's 2018 taxable year. L's next taxable earliest taxable year to which any portion of the payment could be attributed is F's 2019 taxable year. Accordingly, $140,000 of the $200,000 payment is attributed to services performed by O in L's 2019 taxable year.

(vi) The portion of the deferred deduction remuneration attributed to a disqualified taxable year under paragraph (d) of this section that exceeds the deduction limitation for that disqualified taxable year, as reduced, is not deductible for any taxable year. For L's 2018 taxable year, the deductible limitation is reduced to zero by the $450,000 of applicable individual remuneration for that year and the payment of $50,000 of deferred deduction remuneration attributable to that year. Because $60,000 exceeds the reduced deduction limitation of zero, the $60,000 is not deductible for the year of payment (or any other taxable year). For L's 2019 taxable year, the deduction limitation is not reduced because there is no applicable individual remuneration for that year. Because $140,000 does not exceed the unreduced $500,000 limitation, the $140,000 is deductible for 2020, the year of payment. As a result, $140,000 of the $200,000 payment ($0 + $140,000) is deductible for L's 2020 taxable year, and the remaining $60,000 is not deductible by L for any taxable year.

(4) *Application of deduction limitation to aggregated groups of covered health insurance providers*—(i) *In general.* The total combined deduction for applicable individual remuneration and deferred deduction remuneration attributable to services performed by an applicable individual in a disqualified taxable year allowed

for all members of an aggregated group that are treated as covered health insurance providers for any taxable year is limited to $500,000. Therefore, if two or more members of an aggregated group that are treated as covered health insurance providers may otherwise deduct applicable individual remuneration or deferred deduction remuneration attributable to services provided by an applicable individual in a disqualified taxable year, the applicable individual remuneration and deferred deduction remuneration otherwise deductible by all members of the aggregated group is combined, and the deduction limitation is applied to the total amount.

(ii) *Proration of deduction limitation*. If the total amount of applicable individual remuneration or deferred deduction remuneration attributable to services performed by an applicable individual in a disqualified taxable year that is otherwise deductible by two or more members of an aggregated group in any taxable year exceeds the $500,000 deduction limitation (as reduced by previous applications to applicable individual remuneration or deferred deduction remuneration, if applicable), the deduction limitation is prorated based on the applicable individual remuneration and deferred deduction remuneration otherwise deductible by the members of the aggregated group in the taxable year and allocated to each member of the aggregated group. The deduction limitation allocated to each member of the aggregated group is determined by multiplying the deduction limitation for the disqualified taxable year (as previously reduced, if applicable) by a ratio, the numerator of which is the applicable individual remuneration and deferred deduction remuneration otherwise deductible by that member in that taxable year that is attributable to services performed by the applicable individual in the disqualified taxable year, and the denominator of which is the total applicable individual remuneration and deferred deduction remuneration otherwise deductible by all members of the aggregated group in that taxable year that is attributable to services performed by the applicable individual in the disqualified taxable year. The amount of applicable individual remuneration or deferred deduction remuneration otherwise deductible by a member of the aggregated group in excess of the portion of the deduction limitation allocated to that member is not deductible in any taxable year.

(5) *Examples*. The following examples illustrate the rules of paragraph (e)(4) of this section. For purposes of these examples, each corporation has a taxable year that is the calendar year and is a covered health insurance provider for all relevant taxable years, and deferred deduction remuneration is otherwise deductible by the covered health insurance provider in the taxable year in which it is paid.

Example 1. (i) Corporations I, J, and K are members of the same aggregated group under paragraph (b)(3) of this section. In 2016, C is an employee of, and performs services for, I, J, and K. C's total applicable individual remuneration for 2016 is $1,500,000, which consists of $750,000 of applicable individual remuneration for services provided to K; $450,000 of applicable individual remuneration for services provided to J; and $300,000 of applicable individual remuneration for services to I.

(ii) Because I, J, and K are members of the same aggregated group, the applicable individual remuneration otherwise deductible by them is aggregated for purposes of applying the deduction limitation. Further, because the aggregate applicable individual remuneration otherwise deductible by I, J, and K for 2016 exceeds the deduction limitation for C for that taxable year, the deduction limitation is prorated and allocated to the members of the aggregated group in proportion to the applicable individual remuneration otherwise deductible by each member of the aggregated group for that taxable year. Therefore, the deduction limitation that applies to the applicable individual remuneration otherwise deductible by K is $250,000 ($500,000 x ($750,000 / $1,500,000)); the deduction limitation that applies to the applicable individual remuneration otherwise deductible by J is $150,000 ($500,000 x ($450,000 / $1,500,000)); and the deduction limitation that applies to applicable individual remuneration otherwise deductible by I is $100,000 ($500,000 x ($300,000 / $1,500,000)). Therefore, for the 2016 taxable year, K may not deduct $500,000 of the $750,000 of applicable individual remuneration paid to C ($750,000 - $250,000); J may not deduct $300,000 of the $450,000 of applicable individual remuneration paid to C ($450,000 - $150,000); and I may not deduct $200,000 of the $300,000 of applicable individual remuneration paid to C ($300,000 - $100,000).

Example 2. (i) The facts are the same as *Example 1*, except that C's total applicable individual remuneration for 2016 is $400,000, which consists of $75,000 for services provided to K; $150,000 for services provided to J; and $175,000 for services provided to I. In addition, C becomes entitled to $60,000 of deferred deduction remuneration attributable to services provided to K in 2016, which is payable on April 1, 2018, and $75,000 of deferred deduction remuneration attributable to services provided to J in 2016, which is payable on April 1, 2019.

(ii) Because C's total applicable individual remuneration of $400,000 for 2016 for services provided to K, J, and I does not exceed the $500,000 limitation, K, J, and I may deduct $75,000, $150,000, and $175,000, respectively, for 2016. The deduction limitation is then reduced to $100,000 by the total applicable individual remuneration deductible by all members of the aggregated group ($500,000 - $400,000). The deduction limitation, as reduced, is then applied to any deferred deduction remuneration attributable to services provided by C in 2016 in the first subsequent taxable year that it becomes deductible, which is the $60,000 payment made on April 1, 2018. Because the $60,000 of deferred deduction remuneration otherwise deductible by K does not exceed the $100,000 deduction limitation, K may deduct the entire $60,000 for its 2018 taxable year. The $100,000 deduction limitation is then reduced by the $60,000 of deferred deduction remuneration deductible by K for 2018, and the reduced deduction limitation of $40,000 ($100,000 - $60,000) is applied to the $75,000 of deferred deduction remuneration that is otherwise deductible for 2019. Because the deferred deduction remuneration of $75,000 otherwise deductible by J exceeds the reduced deduction limitation of $40,000, J may deduct only $40,000, and the remaining $35,000 ($75,000 - $40,000) is not deductible by J for that taxable year or any other taxable year.

Example 3. (i) The facts are the same as *Example 2*, except that C's deferred deduction remuneration of $75,000 attributable to services performed by C in J's 2016 taxable year is payable on July 1, 2018.

(ii) The results are the same as *Example 2*, except that the reduced deduction limitation of $100,000 is prorated between K and J in proportion to the deferred deduction remuneration otherwise deductible by them for 2018. Accordingly, $44,444 of the remaining deduction limitation is allocated to K ($100,000 x ($60,000 / $135,000)), and $55,556 of the remaining deduction limitation is allocated to J ($100,000 x ($75,000 / $135,000)). Because the $60,000 of deferred deduction remuneration otherwise deductible by K exceeds the $44,444 deduction limitation applied to that remuneration, K may deduct only $44,444 of the $60,000 payment, and $15,556 may not be deducted by K for any taxable year. Similarly, because the $75,000 of deferred deduction remuneration otherwise deductible by J exceeds the $55,556 deduction limitation applied to that remuneration, J may deduct only $55,556 of the $75,000 payment, and $19,444 may not be deducted by J for that taxable year or any other taxable year.

(f) *Corporate transactions*—(1) *Treatment as a covered health insurance provider in connection with a corporate transaction*—(i) *In general*. Except as otherwise provided in this paragraph (f), a person that participates in a corporate transaction is a covered health insurance provider for the taxable year in which the corporate transaction occurs and any subsequent taxable year if it would otherwise be a covered health insurance provider under paragraph (b)(4) of this section for that taxable year. For example, if a member of an aggregated group purchases a health insurance issuer that is a covered health insurance provider (so that the health insurance issuer becomes a member of the

aggregated group), each member of the acquiring aggregated group generally will be a covered health insurance provider for the taxable year in which the corporate transaction occurs and each subsequent taxable year in which the health insurance issuer continues to be a member of the group, unless the *de minimis* exception applies. For purposes of this paragraph (f), the term *corporate transaction* means a merger, acquisition of assets or stock, disposition, reorganization, consolidation, or separation, or any other transaction (including a purchase or sale of stock or other equity interest) resulting in a change in the composition of an aggregated group.

(ii) *Transition period relief for persons becoming covered health insurance providers solely as a result of a corporate transaction*—(A) *In general*. Except as provided in paragraph (f)(1)(ii)(B) of this section, a person that is not a covered health insurance provider before a corporate transaction, but would (except for application of this paragraph (f)(1)(ii)(A)) become a covered health insurance provider solely as a result of the corporate transaction, is not treated as a covered health insurance provider subject to the deduction limitation of section 162(m)(6) in the taxable year of that person in which the corporate transaction occurs (the transition period).

(B) *Certain applicable individuals*. The transition period relief described in paragraph (f)(1)(ii)(A) of this section does not apply with respect to the remuneration of any individual who is an applicable individual of a health insurance issuer that is a covered health insurance provider during its taxable year in which the corporate transaction occurs, even with respect to remuneration attributable to services performed by the applicable individual for a person that is eligible for the transition period relief described in paragraph (f)(1)(ii)(A) of this section. Therefore, each member of an acquiring aggregated group that would become a covered health insurance provider solely as a result of a corporate transaction, but is not treated as a covered health insurance provider under the transition period relief described in paragraph (f)(1)(ii)(A) of this section, is still subject to the deduction limitation of section 162(m)(6) for a taxable year during the transition period with respect to applicable individual remuneration and deferred deduction remuneration attributable to services performed by anyone who is an applicable individual of the acquired health insurance issuer that is a covered health insurance provider.

(iii) *Short taxable years*—(A) *Taxable year ending as a result of a corporate transaction*. As a result of a corporate transaction, a covered health insurance provider's taxable year may end, resulting in a short taxable year. For example, the taxable year of the covered health insurance provider ends if it becomes, or ceases to be, a member of a consolidated group by reason of §1.1502–76(b)(1)(ii)(A)(1). A covered health insurance provider whose taxable year ends as a result of a corporate transaction is treated as a covered health insurance provider for that short taxable year if the covered health insurance provider is a covered health insurance provider within the meaning of paragraph (b)(4) of this section for the short taxable year that ends as a result of the corporate transaction, provided that, for purposes of this paragraph (f)(1)(iii)(A), the *de minimis* exception set forth in paragraph (b)(4)(iii)(A) of this section is available for that short taxable year only if it applied to the covered health insurance provider for the preceding taxable year.

(B) *Taxable year beginning as a result of a corporate transaction*. As a result of a corporate transaction, a covered health insurance provider may begin a new taxable year. For example, if as a result of a corporate transaction, a health insurance issuer that is a covered health insurance provider joins a consolidated group within the meaning of §1.1502–1(h), or a covered health insurance provider ceases to be a member of an aggregated group as a result of a distribution to which section 355 applies, the covered health insurance provider begins a short taxable year. A health insurance issuer that is a covered health insurance provider whose taxable year begins as a result of a corporate transaction is treated as a covered health insurance provider for the taxable year that begins as a result of the corporate transaction if the covered health insurance provider is otherwise a covered health insurance provider within the meaning of paragraph (b)(4) of this section for the taxable year that begins as a result of a corporate transaction, even if it becomes a member of an acquiring aggregate group the other members of which are not treated as covered health insurance providers during that taxable year by reason of the transition period relief under paragraph (f)(1)(ii)(A) of this section, provided that, for purposes of this paragraph (f)(1)(iii)(B), the one-year grace period set forth in paragraph (b)(4)(ii)(B) of this section is available for that short taxable year.

(C) *Deduction limitation not prorated for short taxable years*. If a corporate transaction results in a short taxable year for a covered health insurance provider, the $500,000 deduction limitation for the short taxable year is neither prorated nor reduced. For example, if a corporate transaction results in a short taxable year of three months, the deduction limitation under section 162(m)(6) for that short taxable year is $500,000 (and is not reduced to $125,000).

(2) *Application to partnerships*. The rules in paragraph (f) of this section apply by analogy to transactions involving entities treated as partnerships for purposes of federal taxation.

(3) *Examples*. The following examples illustrate the principles of this paragraph (f). For purposes of these examples, each corporation has a taxable year that is the calendar year unless stated otherwise, and none of the corporations qualify for the *de minimis* exception under paragraph (b)(4)(iii) of this section.

Example 1. (i) Corporation J merges with and into corporation H on June 30, 2015, such that H is the surviving entity. As a result of the merger, J's taxable year ends on June 30, 2015. For its taxable year ending June 30, 2015, J is a covered health insurance provider. For all taxable years before the taxable year of the merger, H is not a covered health insurance provider. However, solely as a result of the merger, H becomes a covered health insurance provider for its 2015 taxable year.

(ii) Corporation J is a covered health insurance provider for its short taxable year ending June 30, 2015. Corporation H is not treated as a covered health insurance provider for its 2015 taxable year by reason of the transition period relief in paragraph (d)(1)(ii)(A) of this section. However, H will be a covered health insurance provider for its 2016 taxable year and all subsequent taxable years for which it is a covered health insurance provider under paragraph (b)(4) of this section.

Example 2. (i) On January 1, 2016, corporations D, E, and F are members of a controlled group within the meaning of section 414(b). F is a health insurance issuer that is a covered health insurance provider under paragraph (b)(4)(i)(B) of this section. D and E are not health insurance issuers (but are treated as covered health insurance providers pursuant to paragraph (b)(4)(i)(C) and (D) of this sec-

tion). F's taxable year is a fiscal year ending on September 30. P is an applicable individual of F for all taxable years. On May 1, 2016, a controlled group within the meaning of section 414(b) consisting of corporations C and B purchases all of the stock of corporation F, resulting in a controlled group within the meaning of section 414(b) consisting of corporations C, B, and F. C and B are not health insurance issuers. The C, B, and F controlled group is a consolidated group within the meaning of §1.1502–1(h). Thus, F's taxable year ends on May 1, 2016 by reason of §1.1502–76(b)(1)(ii)(A)(*1*), and F becomes part of the C, B, and F consolidated group for the taxable year ending December 31, 2016.

(ii) D and E are covered health insurance providers for the taxable year ending December 31, 2016 because they were in an aggregated group with F for a portion of their taxable year. Accordingly, D and E are subject to the deduction limitation under section 162(m)(6) for their taxable years ending December 31, 2016. C and B are not treated as covered health insurance providers for their taxable year ending December 31, 2016, by reason of the transition period relief of paragraph (d)(1)(ii)(A) of this section. F, however, is a covered health insurance provider for its taxable year ending May 1, 2016, and for its taxable year ending December 31, 2016.

(iii) P is an applicable individual whose remuneration is subject to the deduction limitation under section 162(m)(6) for F's short taxable year ending May 1, 2016. In addition, remuneration for services by P for C, B or F after May 1, 2016, during the taxable year of the consolidated group ending December 31, 2016, is subject to the deduction limitation under section 162(m)(6), even though C and B are not treated as covered health insurance providers for their taxable year ending December 31, 2016 by reason of the transition period relief of paragraph (d)(1)(ii)(A) of this section.

Example 3. (i) The same facts as *Example 2*, except that E is a health insurance issuer that is a covered health insurance provider under paragraph (b)(4) of this section, and F is not a health insurance issuer.

(ii) F is a covered health insurance provider for its short taxable year ending May 1, 2016. However, because F is not a health insurance issuer that is a covered health insurance provider, F is not treated as a covered health insurance provider for its short, post-acquisition taxable year ending December 31, 2016, during which it is a member of the consolidated group comprised of C, B, and F.

(iii) P is an applicable individual whose remuneration is subject to the deduction limitation under section 162(m)(6) and paragraph (c) of this section for F's short taxable year ending May 1, 2016. However, because F is not a health insurance issuer, remuneration for P's services for C, B or F after May 1, 2016, during the taxable year of the consolidated group ending December 31, 2016, are not subject to the deduction limitation under section 162(m)(6).

(g) *Coordination*—(1) *Coordination with section 162(m)(1).* If section 162(m)(1) and section 162(m)(6) would both otherwise apply with respect to the remuneration of an applicable individual, the deduction limitation under section 162(m)(6) applies without regard to section 162(m)(1). For example, if an applicable individual is both a covered employee of a publicly held corporation (see sections 162(m)(2) and (3); §1.162–27) and an applicable individual within the meaning of paragraph (b)(7) of this section, remuneration earned by the applicable individual that is attributable to a disqualified taxable year of a covered health insurance provider is subject to the $500,000 deduction limitation under section 162(m)(6) with respect to such disqualified taxable year, without regard to section 162(m)(1).

(2) *Coordination with disallowed excess parachute payments*—(i) *In general*. The $500,000 deduction limitation of section 162(m)(6) is reduced (but not below zero) by the amount (if any) that would have been included in the applicable individual remuneration or deferred deduction remuneration of the applicable individual for a taxable year but for being disallowed by reason of section 280G.

(ii) *Example*. The following example illustrates the rule of this paragraph (g)(2).

Example. Corporation A, a covered health insurance provider, pays $750,000 of applicable individual remuneration to P, an applicable individual, during A's disqualified taxable year ending December 31, 2016. Of the $750,000, $300,000 is an excess parachute payment as defined in section 280G(b)(1), the deduction for which is disallowed by reason of that section. The excess parachute payment reduces the $500,000 deduction limitation to $200,000 ($500,000 - $300,000). Therefore, A may deduct only $200,000 of the $750,000 in applicable individual remuneration, and $250,000 of the payment is not deductible by reason of section 162(m)(6).

(h) *Grandfathered amounts attributable to services performed in taxable years beginning before January 1, 2010*—(1) *In general*. The section 162(m)(6) deduction limitation does not apply to remuneration attributable to services performed in taxable years of a covered health insurance provider beginning before January 1, 2010. For purposes of this paragraph (h), whether remuneration is attributable to services performed in a taxable year beginning before January 1, 2010, is determined by applying an attribution method in paragraph (h)(2) of this section.

(2) *Identification of services performed in taxable years beginning before January 1, 2010*—(i) *Account balance plans*. Deferred deduction remuneration provided under an account balance plan (as defined in §1.409A–1(c)(2)(i)(A) and (B)) is attributable to services performed in a taxable year beginning before January 1, 2010 if it is attributable to services performed before that date under paragraph (d)(3) of this section, without regard to whether that remuneration is subject to a substantial risk of forfeiture on or after that date.

(ii) *Nonaccount balance plans*. The amount of remuneration attributable to services performed in taxable years beginning before January 1, 2010 under a nonqualified deferred compensation plan that is a nonaccount balance plan (as defined in §1.409A–1(c)(2)(i)(C)), equals the present value of the remuneration to which the applicable individual would have been entitled under the plan if the applicable individual voluntarily terminated services without cause on the last day of the first taxable year of the covered health insurance provider beginning before January 1, 2010 and received a payment of the benefit available from the plan on the earliest possible date allowed under the plan to receive a payment of benefits following the termination of service, and received the benefit in the form with the maximum value. Notwithstanding the foregoing, for any subsequent taxable year of the covered health insurance provider, this amount may increase to equal the present value of the benefit the applicable individual actually becomes entitled to receive, in the form and at the time actually paid, determined under the terms of the plan (including applicable limits under the Code) as in effect on the last day of the first taxable year beginning before January 1, 2010 without regard to any further services rendered by the individual after that date or any other events affecting the amount of, or the entitlement to, benefits (other than the applicable individual's election with respect to the time or form of an available benefit). For purposes of calculating the present value of remuneration under this paragraph (h)(2)(ii), reasonable actuarial assumptions and methods, determined as of the date the remuneration is valued, must be used. The present value as of the last day of the first taxable year beginning before January 1, 2010 is determined without regard to whether the remuneration under the nonaccount balance is subject to a substantial risk of forfeiture on or after that date.

(iii) *Equity-based remuneration*. For purposes of this section, all remuneration resulting from a stock option, stock

appreciation right, restricted stock, or restricted stock unit and the right to any associated dividends or dividend equivalents (together, referred to as *equity-based remuneration*) granted before the first day of the taxable year of the covered health insurance provider beginning on or after January 1, 2010, is attributable to services performed in taxable years beginning before January 1, 2010, regardless of the date on which the equity-based remuneration is exercised (in the case of a stock option or SAR), the date on which the amounts due under the equity-based remuneration are paid or includible in income, or whether the equity-based remuneration is subject to a substantial risk of forfeiture on or after the first day of the taxable year of the covered health insurance provider beginning on or after January 1, 2010. For example, appreciation in the value of restricted shares granted before the first day of the taxable year beginning on or after January 1, 2010 is treated as remuneration that is attributable to services performed in taxable years beginning before January 1, 2010, regardless of whether the shares are vested at that time.

(i) *Transition rules for certain deferred deduction remuneration*—(1) *Transition rule for deferred deduction remuneration attributable to services performed in taxable years of the covered health insurance provider beginning after December 31, 2009 and before January 1, 2013*. The deduction limitation under section 162(m)(6) applies to deferred deduction remuneration attributable to services performed in a disqualified taxable year of a covered health insurance provider beginning after December 31, 2009 and before January 1, 2013, only if that remuneration is otherwise deductible in a disqualified taxable year of the covered health insurance provider beginning after December 31, 2012. However, if the deduction limitation applies to deferred deduction remuneration attributable to services performed by an applicable individual in a disqualified taxable year of a covered health insurance provider beginning after December 31, 2009 and before January 1, 2013, the deduction limitation is calculated as if it had been applied to the applicable individual's applicable individual remuneration and deferred deduction remuneration deductible in those taxable years.

(2) *Example*. The following examples illustrate the principles of this paragraph (i). For purposes of these examples, each corporation has a taxable year that is the calendar year, and deferred deduction remuneration is otherwise deductible by the covered health insurance provider in the taxable year in which it is paid.

Example 1. (i) Q is an applicable individual of corporation Z. Z's 2010, 2011, and 2012 taxable years are disqualified taxable years. Z's 2013, 2014, and 2015 taxable years are not disqualified taxable years. However, Z's 2016 taxable year and all subsequent taxable years are disqualified taxable years. Q receives $200,000 of applicable individual remuneration from Z for 2012, and becomes entitled to $800,000 of deferred deduction remuneration that is attributable to services performed by Q in 2012. Z pays Q $350,000 of the deferred deduction remuneration in 2015, and the remaining $450,000 of the deferred deduction remuneration in 2016. These payments are otherwise deductible by Z in 2015 and 2016, respectively.

(ii) Deferred deduction remuneration attributable to services performed by Q in Z's 2010, 2011, and 2012 taxable years that is otherwise deductible in Z's 2013, 2014, or 2015 taxable years is not subject to the deduction limitation under section 162(m)(6) by reason of the transition rule under paragraph (i)(1) of this section. However, deferred deduction remuneration attributable to services performed in Z's 2010, 2011, and 2012 taxable years that is otherwise deductible in a later taxable year that is a disqualified taxable year (in this case, Z's 2016 and subsequent taxable years) is subject to the deduction limitation under section 162(m)(6). Accordingly, the deduction limitation with respect to applicable individual remuneration and deferred deduction remuneration attributable to services performed by Q in 2012 is determined by reducing the $500,000 deduction limitation by the $200,000 of applicable individual remuneration paid to Q by Z for 2012 ($500,000 - $200,000). Under the transition rule of paragraph (i)(1) of this section, no portion of the reduced deduction limitation of $300,000 for the 2012 taxable year is applied against the $350,000 payment made in 2015, and accordingly, the deduction limitation is not reduced by the amount of that payment. The reduced deduction limitation is then applied to Q's $450,000 of deferred deduction remuneration attributable to services performed by Q in 2012 that is paid to Q and becomes otherwise deductible in 2016. Because the reduced deduction limitation of $300,000 is less than the $450,000 otherwise deductible by Z in 2016, Z may deduct only $300,000 of the deferred deduction remuneration, and $150,000 of the $450,000 payment is not deductible by Z in that taxable year or any taxable year.

Example 2. (i) R is an applicable individual of corporation Y, which is a covered health insurance provider for all relevant taxable years. During 2010, Y pays R $400,000 in salary and grants R a right to $200,000 in deferred deduction remuneration payable on a fixed schedule in 2011, 2012, and 2013. Pursuant to the fixed schedule, Y pays R $50,000 of deferred deduction remuneration in 2011, $50,000 of deferred deduction remuneration in 2012, and the remaining $100,000 of deferred deduction remuneration in 2013.

(ii) Because the deduction limitation for deferred deduction remuneration under section 162(m)(6)(A)(ii) is effective for deferred deduction remuneration that is attributable to services performed by an applicable individual during any disqualified taxable year beginning after December 31, 2009 that would otherwise be deductible in a taxable year beginning after December 31, 2012, only the deferred deduction remuneration paid by Y in 2013 is subject to the deduction limitation. However, the limitation is applied as if section 162(m)(6) and paragraph (c)(2) of this section were effective for taxable years beginning after December 31, 2009 and before January 1, 2013. Accordingly, the deduction limitation with respect to remuneration for services performed by R in 2010 is determined by reducing the $500,000 deduction limitation by the $400,000 of applicable individual remuneration paid to R for 2010 ($500,000 - $400,000). The reduced deduction limitation of $100,000 is further reduced to zero by the $50,000 of deferred deduction remuneration attributable to services performed by R in Y's 2010 taxable year that is deductible in each of 2011 and 2012 (($100,000 - $50,000 - $50,000). Because the deduction limitation is reduced to zero, none of the $100,000 of deferred deduction remuneration attributable to services performed by R in Y's 2010 taxable year and paid to R in 2013 is deductible.

(j) *Effective/Applicability dates*. These regulations apply to taxable years that begin after December 31, 2012, and end on or after April 2, 2013. These regulations are effective on publication of final regulations in the **Federal Register**.

Steven T. Miller,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on April 1, 2013, 8:45 a.m., and published in the issue of the Federal Register for April 2, 2013, 78 FR 19950)

Deletions From Cumulative List of Organizations Contributions to Which are Deductible Under Section 170 of the Code

Announcement 2013–32

The Internal Revenue Service has revoked its determination that the organizations listed below qualify as organizations described in sections 501(c)(3) and 170(c)(2) of the Internal Revenue Code of 1986.

Generally, the Service will not disallow deductions for contributions made to a listed organization on or before the date

of announcement in the Internal Revenue Bulletin that an organization no longer qualifies. However, the Service is not precluded from disallowing a deduction for any contributions made after an organization ceases to qualify under section 170(c)(2) if the organization has not timely filed a suit for declaratory judgment under section 7428 and if the contributor (1) had knowledge of the revocation of the ruling or determination letter, (2) was aware that such revocation was imminent, or (3) was in part responsible for or was aware of the activities or omissions of the organization that brought about this revocation.

If on the other hand a suit for declaratory judgment has been timely filed, contributions from individuals and organizations described in section 170(c)(2) that are otherwise allowable will continue to be deductible. Protection under section 7428(c) would begin on May 28, 2013, and would end on the date the court first determines that the organization is not described in section 170(c)(2) as more particularly set forth in section 7428(c)(1). For individual contributors, the maximum deduction protected is $1,000, with a husband and wife treated as one contributor. This benefit is not extended to any individual, in whole or in part, for the acts or omissions of the organization that were the basis for revocation.

Grangeville Country Club, Inc.
Grangeville, ID
Michael Joy Fine Arts Scholarship Fund
Victoria, TX

Definition of Terms

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

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

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

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

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

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

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

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

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

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

Abbreviations

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

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

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[1] A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2012–27 through 2012–52 is in Internal Revenue Bulletin 2012–52, dated December 27, 2012.

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Key to Abbreviations:

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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