Internal Revenue
bulletin

Bulletin No. 2014–41
October 6, 2014

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–105739–11, page 704.

Removal of Allocation Rule for Disbursements from Designated Roth Accounts to Multiple Destinations

Rev. Rul. 2014–26, page 663.

Federal rates; adjusted federal rates; adjusted federal long-term rate and the long-term exempt rate. For purposes of sections 382, 642, 1274, 1288, and other sections of the Code, tables set forth the rates for October 2014.

Rev. Proc. 2014–54, page 675.

This revenue procedure provides the procedures by which a taxpayer may obtain the automatic consent of the Commissioner of Internal Revenue to change to the methods of accounting provided in §§ 1.168(i)–1, 1.168(i)–7, and 1.168(i)–8 of the Income Tax Regulations. This revenue procedure also allows a late partial disposition election under § 1.168(i)–8 to be treated as a change in method of accounting for a limited period of time. Finally, this revenue procedure also modifies section 10.11 of the APPENDIX of Rev. Proc. 2011–14 regarding a change to the method of accounting described in Rev. Proc. 2014–16, 2014–9 I.R.B. 606, for amounts paid to acquire, produce, or improve tangible property. Rev. Proc. 2014–54 modifies the procedures in Rev. Proc. 2011–14, 2011–4 I.R.B. 330, and Rev. Proc. 2014–17, 2014–12 I.R.B. 661, regarding certain changes in method of accounting for dispositions of tangible depreciable property.

Notice 2014–55, page 672.

Notice 2014–55 expands the application of the permitted change rules for health coverage under a § 125 cafeteria plan and addresses two specific situations in which a § 125 cafeteria plan participant is permitted to revoke his or her election under a § 125 cafeteria plan during a period of coverage.

T.D. 9694, page 626.

These final regulations provide guidance on the application of § 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)).

EMPLOYEE PLANS

Notice 2014–54, page 670.

This notice provides rules for allocating pretax and after-tax amounts among disbursements that are made to multiple destinations from a qualified plan described in § 401(a) of the Internal Revenue Code. These rules also apply to disbursements from a § 403(b) plan or a § 457(b) plan maintained by a governmental employer described in § 457(e)(1)(A) (a "governmental § 457(b) plan"). Section VI of this notice provides transition rules.

Notice 2014–55, page 672.

Notice 2014–55 expands the application of the permitted change rules for health coverage under a § 125 cafeteria plan and addresses two specific situations in which a § 125 cafeteria plan participant is permitted to revoke his or her election under a § 125 cafeteria plan during a period of coverage.

(Continued on the next page)

Finding Lists begin on page ii.
Index for July through October begins on page iv.

Department of the Treasury
Internal Revenue Service

T.D. 9693, page 596.

Final regulations (TD 9505) concerning hybrid defined benefit plans under Code sections 411(a)(13) and 411(b)(5) were published in 2010. These final regulations, which finalize proposed regulations that were also published in 2010, provide additional guidance concerning hybrid defined benefit plans under Code sections 411(a)(13) and 411(b)(5), as well as section 411(b)(1). In particular, these final regulations provide guidance as to the scope of relief under section 411(a)(13)(A), contain a special rule regarding the application of the 133 1/3 percent rule under section 411(b)(1)(B) to hybrid defined benefit plans, provide additional rules regarding the market rate of return limitation under section 411(b)(5)(B)(i), and provide guidance with respect to the plan termination rules of section 411(b)(5)(B)(vi).

T.D. 9694, page 626.

These final regulations provide guidance on the application of § 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)).

EXCISE TAX

Notice 2014–49, page 665.

Notice 2014–49 describes a proposed approach to the application of the look-back measurement method, which may be used to determine if an employee is a full-time employee for purposes of § 4980H of the Internal Revenue Code, in situations in which the measurement period applicable to an employee changes. This notice is intended to address the topics for which guidance was anticipated in section VII.G of the preamble to the final § 4980H regulations (79 FR 8544, 8563 (Feb. 12, 2014)).

Notice 2014–56, page 674.

Notice 2014–56 provides the applicable dollar amount that applies for determining the fee imposed by §§ 4375 and 4376 for policy years and plan years ending on or after October 1, 2014 and Before September 30, 2015.

ADMINISTRATIVE

Notice 2014–56, page 674.

Notice 2014–56 provides the applicable dollar amount that applies for determining the fee imposed by §§ 4375 and 4376 for policy years and plan years ending on or after October 1, 2014 and Before September 30, 2015.

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 42.—Low-Income Housing Credit

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 2014. See Rev. Rul. 2014-26, page 663.

Section 280G.—Golden Parachute Payments

Federal short-term, mid-term, and long-term rates are set forth for the month of October 2014. See Rev. Rul. 2014–26, page 663.

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

The adjusted applicable federal long-term rate is set forth for the month of October 2014. See Rev. Rul. 2014–26, page 663.

Section 411.—Minimum Vesting Standards

26 CFR 1.411(a)(13)–1: Statutory hybrid plans.

TD 9693

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

Additional Rules Regarding Hybrid Retirement Plans

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations providing guidance relating to applicable defined benefit plans. Applicable defined benefit plans are defined benefit plans that use a lump sum-based benefit formula, including cash balance plans and pension equity plans, as well as other hybrid retirement plans that have a similar effect. These regulations provide guidance relating to certain provisions that apply to applicable defined benefit plans that were added to the Internal Revenue Code (Code) by the Pension Protection Act of 2006, as amended by the Worker, Retiree, and Employer Recovery Act of 2008. These regulations affect sponsors, administrators, participants, and beneficiaries of these plans.

DATES: *Effective Date*: These regulations are effective on September 19, 2014.

Applicability Date: These regulations generally apply to plan years that begin on or after January 1, 2016. However, see the "Effective/Applicability Dates" section in this preamble for additional information regarding the applicability of these regulations.

FOR FURTHER INFORMATION CONTACT: Neil S. Sandhu or Linda S. F. Marshall at (202) 317-6700 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains amendments to the Income Tax Regulations (26 CFR part 1) under sections 411(a)(13), 411(b)(1), and 411(b)(5) of the Code. Generally, a defined benefit pension plan must satisfy the minimum vesting standards of section 411(a) and the accrual requirements of section 411(b) in order to be qualified under section 401(a) of the Code. Sections 411(a)(13) and 411(b)(5), which modify the minimum vesting standards of section 411(a) and the accrual requirements of section 411(b), were added to the Code by section 701(b) of the Pension Protection Act of 2006, Public Law 109–280 (120 Stat. 780 (2006)) (PPA '06). Sections 411(a)(13) and 411(b)(5), as well as certain effective date provisions related to these sections, were subsequently amended by the Worker, Retiree, and Employer Recovery Act of 2008, Public Law 110–458 (122 Stat. 5092 (2008)) (WRERA '08).

Section 411(a)(13)(A) provides that an applicable defined benefit plan (which is defined in section 411(a)(13)(C)) is not treated as failing to meet either (i) the requirements of section 411(a)(2) (subject to a special vesting rule in section 411(a)(13)(B) with respect to benefits derived from employer contributions) or (ii) the requirements of section 411(a)(11), 411(c), or 417(e), with respect to accrued benefits derived from employer contributions, merely because the present value of the accrued benefit (or any portion thereof) of any participant is, under the terms of the plan, equal to the amount expressed as the balance of a hypothetical account or as an accumulated percentage of the participant's final average compensation. Section 411(a)(13)(B) requires an applicable defined benefit plan to provide that an employee who has completed at least 3 years of service has a nonforfeitable right to 100 percent of the employee's accrued benefit derived from employer contributions.

Under section 411(a)(13)(C)(i), an applicable defined benefit plan is defined as a defined benefit plan under which the accrued benefit (or any portion thereof) of a participant is calculated as the balance of a hypothetical account maintained for the participant or as an accumulated percentage of the participant's final average compensation. Under section 411(a)(13)(C)(ii), the Secretary of the Treasury is to issue regulations which include in the definition of an applicable defined benefit plan any defined benefit plan (or portion of such a plan) which has an effect similar to a plan described in section 411(a)(13)(C)(i).

Section 411(a) requires that a defined benefit plan satisfy the requirements of section 411(b)(1). Section 411(b)(1) provides that a defined benefit plan must satisfy one of the three accrual rules of section 411(b)(1)(A), (B) and (C) with respect to benefits accruing under the plan. The three accrual rules are the 3 percent method of section 411(b)(1)(A), the 133⅓ percent rule of section 411(b)(1)(B), and the fractional rule of section 411(b)(1)(C).

Section 411(b)(1)(B) provides that a defined benefit plan satisfies the requirements of the 133⅓ percent rule for a particular plan year if, under the plan, the accrued benefit payable at the normal retirement age is equal to the normal retirement benefit, and the annual rate at which any individual who is or could be a participant can accrue the retirement benefits payable at normal retirement age under the plan for any later plan year is not more than 133⅓ percent of the annual rate at which the individual can accrue benefits for any plan year beginning on or after such particular plan year and before such later plan year.

For purposes of applying the 133⅓ percent rule, section 411(b)(1)(B)(i) provides that any amendment to the plan which is in effect for the current year is treated as in effect for all other plan years. Section 411(b)(1)(B)(ii) provides that any change in an accrual rate which does not apply to any individual who is or could be a participant in the current plan year is disregarded. Section 411(b)(1)(B)(iii) provides that the fact that benefits under the plan may be payable to certain participants before normal retirement age is disregarded. Section 411(b)(1)(B)(iv) provides that Social Security benefits and all other relevant factors used to compute benefits are treated as remaining constant as of the current plan year for all years after the current year.

Section 411(b)(1)(G) provides that a defined benefit plan fails to comply with section 411(b) if the participant's accrued benefit is reduced on account of any increase in the participant's age or service. Section 411(b)(1)(G) contains a limited exception to this requirement for any social security supplement.

Section 411(b)(1)(H)(i) provides that a defined benefit plan fails to comply with section 411(b) if, under the plan, an employee's benefit accrual is ceased, or the rate of an employee's benefit accrual is reduced, because of the attainment of any age. Section 411(b)(5), which was added to the Code by section 701(b)(1) of PPA '06, provides additional rules related to section 411(b)(1)(H)(i). Section 411(b)(5)(A) generally provides that a plan is not treated as failing to meet the requirements of section 411(b)(1)(H)(i) if a participant's accrued benefit, as determined as of any date under the terms of the plan, would be equal to or greater than that of any similarly situated, younger individual who is or could be a participant. For this purpose, section 411(b)(5)(A)(iv) provides that the accrued benefit may, under the terms of the plan, be expressed as an annuity payable at normal retirement age, the balance of a hypothetical account, or the current value of the accumulated percentage of the employee's final average compensation. Section 411(b)(5)(G) provides that, for purposes of section 411(b)(5), any reference to the accrued benefit of a participant refers to the participant's benefit accrued to date.

Section 411(b)(5)(B) imposes certain requirements on an applicable defined benefit plan in order for the plan to satisfy section 411(b)(1)(H). Section 411(b)(5)(B)(i) provides that such a plan is treated as failing to meet the requirements of section 411(b)(1)(H) if the terms of the plan provide for an interest credit (or an equivalent amount) for any plan year at a rate that is greater than a market rate of return. Under section 411(b)(5)(B)(i)(I), a plan is not treated as having an above-market rate merely because the plan provides for a reasonable minimum guaranteed rate of return or for a rate of return that is equal to the greater of a fixed or variable rate of return. Section 411(b)(5)(B)(i)(II) provides that an applicable defined benefit plan is treated as failing to meet the requirements of section 411(b)(1)(H) unless the plan provides that an interest credit (or an equivalent amount) of less than zero can in no event result in the account balance or similar amount being less than the aggregate amount of contributions credited to the account. Section 411(b)(5)(B)(i)(III) authorizes the Secretary of the Treasury to provide by regulation for rules governing the calculation of a market rate of return for purposes of section 411(b)(5)(B)(i)(I) and for permissible methods of crediting interest to the account (including fixed or variable interest rates) resulting in effective rates of return meeting the requirements of section 411(b)(5)(B)(i)(I).

Sections 411(b)(5)(B)(ii), 411(b)(5)(B)(iii) and 411(b)(5)(B)(iv) contain additional requirements that apply if, after June 29, 2005, an applicable plan amendment is adopted. Section 411(b)(5)(B)(v)(I) defines an applicable plan amendment as an amendment to a defined benefit plan which has the effect of converting the plan to an applicable defined benefit plan. Under section 411(b)(5)(B)(ii), if, after June 29, 2005, an applicable plan amendment is adopted, the plan is treated as failing to meet the requirements of section 411(b)(1)(H) unless the requirements of section 411(b)(5)(B)(iii) are met with respect to each individual who was a participant in the plan immediately before the adoption of the amendment. Section 411(b)(5)(B)(iii) specifies that, subject to section 411(b)(5)(B)(iv), the requirements of section 411(b)(5)(B)(iii) are met with respect to any participant if the accrued benefit of the participant under the terms of the plan as in effect after the amendment is not less than the sum of: (I) the participant's accrued benefit for years of service before the effective date of the amendment, determined under the terms of the plan as in effect before the amendment; plus (II) the participant's accrued benefit for years of service after the effective date of the amendment, determined under the terms of the plan as in effect after the amendment. Section 411(b)(5)(B)(iv) provides that, for purposes of section 411(b)(5)(B)(iii)(I), the plan must credit the participant's account or similar amount with the amount of any early retirement benefit or retirement-type subsidy for the plan year in which the participant retires if, as of such time, the participant has met the age, years of service, and other requirements under the plan for entitlement to such benefit or subsidy.

Section 411(b)(5)(B)(v) sets forth certain provisions related to an applicable plan amendment. Section 411(b)(5)(B)(v)(II) provides that if the benefits under two or more defined benefit plans of an employer are coordinated in such a manner as to have the effect of adoption of an applicable plan amendment, the plan sponsor is treated as having adopted an applicable plan amendment as of the date the coordination begins. Section 411(b)(5)(B)(v)(III) directs the Secretary of the Treasury to issue regulations to prevent the avoidance of the purposes of section 411(b)(5)(B) through the use of two or more plan amendments rather than a single amendment.

Section 411(b)(5)(B)(vi) provides special rules for determining benefits upon termination of an applicable defined benefit plan. Under section 411(b)(5)(B)(vi)(I), an applicable defined benefit plan is not treated as satisfying the requirements of section 411(b)(5)(B)(i) (regarding permissible interest crediting rates) unless the plan provides that, upon plan termination, if the interest crediting rate under the plan is a variable rate, the rate of interest used to determine accrued benefits under the plan is equal to the average of the rates of interest used under the plan during the 5-year period ending on the termination date. In addition, under section 411(b)(5)(B)(vi)(II), the plan must provide that, upon plan termination, the interest rate and mortality table used to determine the amount of any benefit under the plan payable in the form of an annuity payable at normal retirement age is the rate and table specified under the plan for this purpose as of the termination date, except that if the interest rate is a variable rate, the rate used is the average of the rates used under the plan during the 5-year period ending on the termination date.

Section 411(b)(5)(C) provides that a plan is not treated as failing to meet the requirements of section 411(b)(1)(H)(i) solely because the plan provides offsets against benefits under the plan to the extent the offsets are otherwise allowable in applying the requirements of section 401(a). Section 411(b)(5)(D) provides that a plan is not treated as failing to meet the requirements of section 411(b)(1)(H) solely because the plan provides a disparity in contributions or benefits with respect to which the requirements of section 401(l) (relating to permitted disparity for Social Security benefits and related matters) are met.

Section 411(b)(5)(E) provides that a plan is not treated as failing to meet the requirements of section 411(b)(1)(H) solely because the plan provides for indexing of accrued benefits under the plan. Under section 411(b)(5)(E)(iii), indexing means the periodic adjustment of the accrued benefit by means of the application of a recognized investment index or methodology. Section 411(b)(5)(E)(ii) requires that, except in the case of a variable annuity, the indexing not result in a smaller benefit than the accrued benefit determined without regard to the indexing.

Except to the extent permitted under section 411(d)(6) (or under another statutory provision, including section 1107 of PPA '06), section 411(d)(6) prohibits a plan amendment that decreases a participant's accrued benefits or that has the effect of eliminating or reducing an early retirement benefit or retirement-type subsidy, or eliminating an optional form of benefit, with respect to benefits attributable to service before the amendment. However, an amendment that eliminates or decreases benefits that have not yet accrued does not violate section 411(d)(6), provided that the amendment is adopted and effective before the benefits accrue.

Section 701(a) of PPA '06 added provisions to the Employee Retirement Income Security Act of 1974, Public Law 93–406 (88 Stat. 829 (1974)), as amended (ERISA), that are parallel to sections 411(a)(13) and 411(b)(5) of the Code. The guidance provided in these regulations with respect to sections 411(a)(13) and 411(b)(5) of the Code also apply for purposes of the parallel amendments to ERISA made by section 701(a) of PPA '06, and the guidance provided in these regulations with respect to section 411(b)(1) of the Code also apply for purposes of section 204(b)(1) of ERISA.[1]

Section 701(c) of PPA '06 added provisions to the Age Discrimination in Employment Act of 1967, Public Law 90–202 (81 Stat. 602 (1967)), that are parallel to section 411(b)(5) of the Code. Executive Order 12067 requires all Federal departments and agencies to advise and offer to consult with the Equal Employment Opportunity Commission (EEOC) during the development of any proposed rules, regulations, policies, procedures, or orders concerning equal employment opportunity. The Treasury Department and the IRS have consulted with the EEOC prior to the issuance of these regulations.

Section 701(d) of PPA '06 provides that nothing in the amendments made by section 701 should be construed to create an inference concerning the treatment of applicable defined benefit plans or conversions of plans into applicable defined benefit plans under section 411(b)(1)(H), or concerning the determination of whether an applicable defined benefit plan fails to meet the requirements of section 411(a)(2), 411(c) or 417(e), as in effect before such amendments, solely because the present value of the accrued benefit (or any portion thereof) of any participant is, under the terms of the plan, equal to the amount expressed as the balance of a hypothetical account or as an accumulated percentage of the participant's final average compensation.

Section 701(e) of PPA '06 sets forth the effective date provisions with respect to amendments made by section 701 of PPA '06. Section 701(e)(1) specifies that the amendments made by section 701 generally apply to periods beginning on or after June 29, 2005. Thus, the age discrimination safe harbors under section 411(b)(5)(A) and section 411(b)(5)(E) are effective for periods beginning on or after June 29, 2005. Section 701(e)(2) provides that the special present value rules of section 411(a)(13)(A) are effective for distributions made after August 17, 2006 (the date PPA '06 was enacted).

Under section 701(e) of PPA '06, the 3-year vesting rule under section 411(a)(13)(B) is generally effective for years beginning after December 31, 2007, for a plan in existence on June 29, 2005, while, pursuant to the amendments made by section 107(c) of WRERA '08, the rule is generally effective for plan years ending on or after June 29, 2005, for a plan not in existence on June 29, 2005. The market rate of return limitation under section 411(b)(5)(B)(i) is generally effective for years beginning after December 31, 2007, for a plan in existence on June 29, 2005, while the limitation is generally effective for periods beginning on or after June 29, 2005, for a plan not in existence on June 29, 2005. Section 701(e)(4) of PPA '06 contains special effective date provisions for collectively bargained plans that modify these effective dates.

Under section 701(e)(5) of PPA '06, as amended by WRERA '08, sections 411(b)(5)(B)(ii), (iii) and (iv) apply to a conversion amendment that is adopted on or after, and takes effect on or after, June 29, 2005.

Under section 701(e)(6) of PPA '06, as added by WRERA '08, the 3-year vesting

[1]Under section 101 of Reorganization Plan No. 4 of 1978 (43 FR 47713), the Secretary of the Treasury has interpretive jurisdiction over the subject matter addressed by these regulations for purposes of ERISA, as well as the Code.

rule under section 411(a)(13)(B) does not apply to a participant who does not have an hour of service after the date the 3-year vesting rule would otherwise be effective.

Section 702 of PPA ’06 provides for regulations to be prescribed by August 16, 2007, addressing the application of rules set forth in section 701 of PPA ’06 in the case of a conversion of a defined benefit pension plan to an applicable defined benefit plan that is made with respect to a group of employees who become employees by reason of a merger, acquisition, or similar transaction.

Section 1.411(a)–7(a)(1) of the Income Tax Regulations provides that, for purposes of section 411 and the regulations under section 411, the accrued benefit of a participant under a defined benefit plan is either (A) the accrued benefit determined under the plan if the plan provides for an accrued benefit in the form of an annual benefit commencing at normal retirement age, or (B) an annual benefit commencing at normal retirement age which is the actuarial equivalent (determined under section 411(c)(3) and § 1.411(c)–1)) of the accrued benefit under the plan if the plan does not provide for an accrued benefit in the form of an annual benefit commencing at normal retirement age.

Section 1.411(b)–1(a)(1) provides that a defined benefit plan is not a qualified plan unless the method provided by the plan for determining accrued benefits satisfies at least one of the alternative methods in § 1.411(b)–1(b) for determining accrued benefits with respect to all active participants under the plan. Section 1.411(b)–1(b)(2)(i) provides that a defined benefit plan satisfies the 133⅓ percent rule of section 411(b)(1)(B) for a particular plan year if (A) under the plan the accrued benefit payable at the normal retirement age (determined under the plan) is equal to the normal retirement benefit (determined under the plan), and (B) the annual rate at which any individual who is or could be a participant can accrue the retirement benefits payable at normal retirement age under the plan for any later plan year cannot be more than 133⅓ percent of the annual rate at which the participant can accrue benefits for any plan year beginning on or after such particular plan year and before such later plan year. Section 1.411(b)–1(b)(2)(ii)(A) through (D) sets forth a series of rules that correspond to the rules of section 411(b)(1)(B)(i) through (iv). Section 1.411(b)–1(b)(2)(ii)(D) provides that, for purposes of the 133⅓ percent rule, for any plan year, social security benefits and all relevant factors used to compute benefits, for example, the consumer price index, are treated as remaining constant as of the beginning of the current plan year for all subsequent plan years.

Final regulations (TD 9505) under sections 411(a)(13) and 411(b)(5) (2010 final regulations) were published by the Treasury Department and the IRS in the **Federal Register** on October 19, 2010 (75 FR 64123).

Proposed regulations (REG–132554–08) under sections 411(a)(13), 411(b)(1), and 411(b)(5) (2010 proposed regulations) were also published by the Treasury Department and the IRS in the **Federal Register** on October 19, 2010 (75 FR 64197). The 2010 proposed regulations address certain issues under sections 411(a)(13) and 411(b)(5) that were not addressed in the 2010 final regulations. The 2010 proposed regulations also address one issue under the 133⅓ percent rule of section 411(b)(1)(B) for defined benefit plans that adjust benefits using a variable rate that could be negative. The Treasury Department and the IRS received written comments on the 2010 proposed regulations, and a public hearing was held on January 26, 2011.

Notice 2011–85 (2011–44 IRB 605 (October 31, 2011)), (see § 601.601(d)(2)(ii)(*b*) of this chapter), announced delayed effective/applicability dates with respect to certain provisions in the hybrid plan regulations. In particular, Notice 2011–85 provided that the provisions to be adopted under the regulations that finalize the 2010 proposed regulations would apply for plan years that begin on or after the date specified in those regulations, which would not be earlier than January 1, 2013. Notice 2011–85 also provided that the Treasury Department and the IRS intended to amend the hybrid plan regulations to postpone the effective/applicability date of § 1.411(b)(5)–1(d)(1)(iii), (d)(1)(vi) and (d)(6)(i) (the provisions that provide that the regulations set forth the list of the interest crediting rates and combinations of rates that satisfy the requirements of section 411(b)(5)(B)(i)) to match the effective/applicability date of the new provisions in the regulations. Notice 2011–85 further provided that, when the 2010 proposed regulations are finalized, it was expected that relief from the requirements of section 411(d)(6) would be granted for a plan amendment that eliminates or reduces a section 411(d)(6) protected benefit, provided that the amendment is adopted by the last day of the first plan year preceding the plan year for which the 2010 proposed regulations, once finalized, apply to the plan, and the elimination or reduction is made only to the extent necessary to enable the plan to meet the requirements of section 411(b)(5). In addition, Notice 2011–85 extended the deadline for amending cash balance and other applicable defined benefit plans, within the meaning of section 411(a)(13)(C), to meet the requirements of section 411(a)(13) (other than section 411(a)(13)(A)) and section 411(b)(5), relating to vesting and other special rules applicable to these plans. Under Notice 2011–85, the deadline for these amendments was the last day of the first plan year preceding the plan year for which the 2010 proposed regulations, once finalized, apply to the plan.

Notice 2012–61 (2012–42 IRB 479 (October 15, 2012)), (see § 601.601(d)(2)(ii)(*b*) of this chapter), announced that the regulations described in Notice 2011–85 would not be effective for plan years beginning before January 1, 2014.

After consideration of the comments received, the provisions in the 2010 proposed regulations are adopted by this Treasury decision, subject to a number of changes that are summarized in this preamble. In addition, the Treasury Department and the IRS are issuing proposed regulations that would permit a plan with a noncompliant interest crediting rate to be amended so that its interest crediting rate complies with the market rate of return rules without violating the section 411(d)(6) prohibition on a plan amendment reducing a participant’s accrued benefit. These proposed regulations are being issued at the same time as these final regulations.

Explanation of Provisions

Overview

In general, these regulations provide guidance with respect to certain issues under sections 411(a)(13) and 411(b)(5) that are not addressed in the 2010 final regulations and make certain other changes to the final regulations under sections 411(a)(13) and 411(b)(5). In addition, these regulations provide guidance with respect to one issue under the 133⅓ percent rule of section 411(b)(1)(B) for defined benefit plans that adjust benefits using a variable rate that could be negative.

I. *Section 411(a)(13): Scope of relief of section 411(a)(13)(A)*

A. *Formulas to which relief applies*

Pursuant to the relief of section 411(a)(13)(A), the 2010 final regulations provide that certain rules otherwise applicable to benefits under a defined benefit plan are not violated solely because certain benefits determined under a lump sum-based benefit formula are based on the current lump sum amount under that formula. The 2010 final regulations define a lump sum-based benefit formula as a benefit formula used to determine all or any part of a participant's accumulated benefit under which the accumulated benefit provided under the formula is expressed as the current balance of a hypothetical account maintained for the participant ("cash balance" formula) or as the current value of an accumulated percentage of the participant's final average compensation ("pension equity plan" or "PEP" formula).

For plan years that begin on or after January 1, 2016 (or an earlier date as elected by the taxpayer), these regulations expand the definition of PEP formula to include a benefit formula that is expressed as a current single-sum dollar amount equal to a percentage of the participant's *highest* average compensation (with a permitted lookback period for determining highest average compensation, such as highest 5 out of the last 10 years).

In addition, for plan years that begin on or after January 1, 2016, these regulations provide that a benefit formula does not constitute a lump sum-based benefit formula unless a distribution of the benefits under that formula in the form of a single-sum payment equals the accumulated benefit under that formula (except to the extent the single-sum payment is greater to satisfy the requirements of section 411(d)(6)).

B. *Protections with respect to current account balance or current value.*

The relief of section 411(a)(13)(A) generally permits a plan to treat the accumulated benefit under a cash balance formula ("cash balance account") or the accumulated benefit under a PEP formula ("PEP accumulation") as the present value of the portion of the accrued benefit determined under the cash balance or PEP formula. The 2010 proposed regulations contained three requirements that applied to the cash balance account or PEP accumulation. These requirements were structured as conditions on the availability of the relief of section 411(a)(13)(A). A number of commenters objected to treating these requirements as conditions for this relief. In response to those comments, the structure of the regulations under section 411(a)(13)(A) has been revised to clarify that two of the requirements are only intended to provide the same types of protections to the accumulated benefit under a cash balance formula and under a PEP formula as are afforded to the accrued benefit.

For example, these final regulations provide that the relief of section 411(a)(13) does not override the requirement for a plan that, with respect to a participant with an annuity starting date after normal retirement age, the plan either provide an actuarial increase after normal retirement age or satisfy the requirements for suspension of benefits under section 411(a)(3)(B). Accordingly, with respect to such a participant, a plan with a cash balance or PEP formula violates the requirements of section 411(a) if the cash balance account or PEP accumulation is not increased sufficiently to satisfy the requirements of section 411(a)(2) for distributions commencing after normal retirement age, unless the plan suspends benefits in accordance with section 411(a)(3)(B).

Like the 2010 proposed regulations, these final regulations provide that the cash balance account or PEP accumulation can only be reduced for certain limited reasons, which generally correspond to the limited reasons for which the accrued benefit can be reduced. Several commenters on the 2010 proposed regulations suggested that it was unclear whether the restrictions on reductions as applied to PEP formulas were intended to cover only reductions that reduced the accumulated percentage that applies to the participant's final average compensation or whether the restrictions were also intended to disallow reductions that were a result of decreases in the participant's final average compensation. In response to those comments, the regulations clarify that a reduction in the PEP accumulation is permitted to the extent that it results from a decrease in the participant's final average compensation or from an increase in the integration level (in the case of a formula that is integrated with Social Security). The regulations also contain a provision allowing the Commissioner to add to the list of permitted reductions through guidance of general applicability.

Under the 2010 proposed regulations, a cash balance formula or PEP formula would have had to provide that the portion of the participant's accrued benefit that is determined under that formula must be actuarially equivalent (using reasonable actuarial assumptions) to the cash balance account or PEP accumulation upon attainment of normal retirement age in order to apply the relief of section 411(a)(13)(A). Under these final regulations, a cash balance formula or PEP formula is treated as a lump sum-based benefit formula to which the relief of section 411(a)(13)(A) applies if the portion of the participant's accrued benefit that is determined under that formula is actuarially equivalent (using reasonable actuarial assumptions) to the cash balance account or PEP accumulation either upon attainment of normal retirement age or at the annuity starting date for a distribution with respect to that portion.

If a formula is not a lump sum-based benefit formula, the plan must satisfy the rules that otherwise apply for purposes of determining benefits under a defined benefit plan, such as applying the minimum present value requirements of section 417(e) to the portion of the accrued benefit determined under that formula in order to determine the amount of a single-sum distribution option.

C. *Subsidies and benefits that are less than the actuarial equivalent of the cash balance account or PEP accumulation*

The 2010 proposed regulations provided that the relief of section 411(a)(13)(A) applies to an optional form of benefit that is determined as of the annuity starting date as the actuarial equivalent, using reasonable actuarial assumptions, of the cash balance account or PEP accumulation. In response to comments that subsidized benefits should be permissible, the rules in the regulations under section 411(a)(13) have been revised to clarify that the relief of section 411(a)(13)(A) also applies to a subsidized optional form of benefit under a lump sum-based benefit formula, including an early retirement subsidy or a subsidized survivor portion of a qualified joint and survivor annuity. In particular, these final regulations provide that, with respect to benefits under a lump sum-based benefit formula, if an optional form of benefit is payable in an amount that is greater than the actuarial equivalent, determined using reasonable actuarial assumptions, of the cash balance account or PEP accumulation, then the plan satisfies the requirements of section 411(a)(2), 411(a)(11), 411(c) and 417(e) with respect to the amount of that optional form of benefit.[2]

By contrast, section 411(a)(13)(A) does not provide relief with respect to an optional form of benefit that is less than the actuarial equivalent of the cash balance account or PEP accumulation. Thus, the final regulations provide that if an optional form of benefit is not at least the actuarial equivalent, using reasonable actuarial assumptions, of the cash balance account or PEP accumulation, then the relief under section 411(a)(13)(A) does not apply in determining whether the optional form of benefit is the actuarial equivalent of the portion of the accrued benefit determined under the cash balance or PEP formula. As a result, payment of that optional form of benefit must satisfy the rules applicable to payment of the accrued benefit generally under a defined benefit plan (without regard to the special rules of section 411(a)(13)(A) and the regulations), including the requirements of section 411(a)(2) and, for optional forms subject to the minimum present value requirements of section 417(e)(3), those minimum present value requirements.

D. *Clarifications relating to statutory hybrid formulas with an effect similar to a lump sum-based benefit formula*

Under the 2010 final regulations, a formula that is not a lump sum-based benefit formula that has an effect similar to a lump sum-based benefit formula is nevertheless a statutory hybrid benefit formula. As a result, such a formula is subject to the 3-year vesting rule of section 411(a)(13)(B) and the rules of section 411(b)(5), including the market rate of return and conversion protection requirements. However, because it is not a lump sum-based benefit formula, such a formula is not eligible for the relief of section 411(a)(13)(A). In general, a defined benefit formula that is not a lump sum-based benefit formula has an effect similar to a lump sum-based benefit formula if the formula provides that a participant's accumulated benefit is expressed as a benefit that includes the right to adjustments for a future period and the total dollar amount of those adjustments is reasonably expected to be smaller for the participant than for a similarly situated, younger individual who is or could be a participant in the plan.

These regulations clarify certain of the rules with respect to the determination as to whether a formula constitutes a formula with an effect similar to a lump sum-based benefit formula. In particular, these regulations clarify that the right to adjustments for a future period is broadly defined to mean the right to any change in the dollar amount of benefits over time, regardless of whether those adjustments are denominated as interest credits. Thus, for example, an increase in the dollar amount of benefits over time (such as an actuarial increase or the unwinding of an actuarial reduction for early retirement) is treated as an adjustment.

However, this broad definition does not cause a defined benefit formula to be treated as having an effect similar to a lump sum-based benefit formula with respect to a participant merely because the formula provides for a reduction in the benefit payable at early retirement due to early commencement (with the result that the benefit payable at normal retirement age is greater than the benefit payable at early retirement), provided that the benefit payable at normal retirement age to the participant cannot be less than the benefit payable at normal retirement age to any similarly situated, younger individual who is or could be a participant in the plan. This exception has the effect of excluding traditional defined benefit formulas (and other formulas that provide for mere actuarial reduction for early commencement) from treatment as a formula with an effect similar to a lump sum-based benefit formula, notwithstanding the treatment of actuarial increases in benefits over time as adjustments.

Under the 2010 final regulations, a variable annuity benefit formula was defined as any benefit formula under a defined benefit plan which provides that the amount payable is periodically adjusted by reference to the difference between the rate of return on plan assets (or specified market indices) and a specified assumed interest rate. In addition, the 2010 final regulations contained a special rule that provided an exception from treatment as a formula with an effect similar to a lump sum-based benefit formula for a variable annuity benefit formula with an assumed interest rate of 5 percent or higher.

In order to clarify this exception, both the definition and the exception have been revised under these regulations. In particular, the definition of variable annuity benefit formula has been broadened. Thus, these regulations provide that a variable annuity benefit formula means any benefit formula under a defined benefit plan which provides that the amount payable is periodically adjusted by reference to the difference between a rate of return (not limited to the rate of return on plan assets or specified market indices) and a speci-

[2]As set forth later in this preamble, the regulations under section 411(b)(5) provide rules under the age discrimination safe harbor that limit the amount of the subsidized early retirement benefit so that it does not exceed the benefit available to a similarly situated, older participant with the same cash balance account or PEP accumulation who is currently at normal retirement age.

fied assumed interest rate. The exception has been revised so that it is available in the case of any variable annuity benefit formula that adjusts the amounts payable by reference to any rate of return that is permissible as an interest crediting rate under the regulations, including the rate of return on plan assets (or a subset of plan assets), as described in section III.C.2 of this preamble, or the rate of return on an annuity contract for an employee issued by an insurance company licensed under the laws of a State. The rule in the regulations that provides that this exception is only available if the specified assumed interest rate is 5 percent or higher has been retained.

A variable annuity benefit formula that does not fall within the exception must be tested to determine whether it has an effect similar to a lump sum-based benefit formula. Such a formula is not a statutory hybrid benefit formula if the specified assumed interest rate is high enough in relation to the reasonable expectation of the rate of return to which it is compared, such that the adjustments under the formula are not reasonably expected to be positive. However, if the specified assumed interest rate is too high in relation to the reasonable expectation of the rate of return to which it is compared, a variable annuity benefit formula risks violating section 411(b)(1)(G).

E. *Formulas that express the accumulated benefit as a single-sum dollar amount at normal retirement age*

As discussed earlier in this preamble, the 2010 final regulations define a lump sum-based benefit formula as a benefit formula used to determine all or any part of a participant's accumulated benefit under which the accumulated benefit provided under the formula is expressed as the current balance of a hypothetical account maintained for the participant or as the current value of an accumulated percentage of the participant's final average compensation. Under this rule, a benefit formula is a lump sum-based benefit formula if it expresses the accumulated benefit as a current single-sum dollar amount, regardless of whether interest credits are provided.

With respect to a plan that does not provide interest credits, there may be a question as to whether the accumulated benefit is a current single-sum dollar amount or is a single-sum dollar amount at normal retirement age. Accordingly, the 2010 proposed regulations included a comment request with respect to whether a defined benefit plan that expresses the participant's accumulated benefit as a current single-sum dollar amount and that does not provide for interest credits should be excluded from the definition of a statutory hybrid plan. Commenters suggested that a benefit formula that expresses the participant's benefit as a current single-sum dollar amount (for example, a PEP formula) should be treated as a statutory hybrid benefit formula, regardless of whether interest credits are provided. Because the statutory language with respect to a cash balance formula and a PEP formula does not specify that interest credits must be provided, the Treasury Department and the IRS agree with this recommendation. As a result, the definition of lump sum-based benefit formula continues not to require that interest credits be provided.

Commenters also recommended that plans that express the accumulated benefit as a single-sum dollar amount at normal retirement age, rather than as a current single-sum dollar amount, should not be treated as statutory hybrid plans. The Treasury Department and the IRS generally agree with this recommendation. Accordingly, the definition of lump sum-based benefit formula continues to require that the benefit be expressed as a current single-sum dollar amount. Thus, a benefit formula that expresses the accumulated benefit as a single-sum dollar amount at normal retirement age is not a statutory hybrid benefit formula unless the formula includes the right to adjustments such that the formula has an effect similar to a lump sum-based benefit formula pursuant to § 1.411(a)(13)–1(d)(4)(ii) (see section I.D of this preamble).

The Treasury Department and the IRS believe that this treatment under the regulations is consistent with the intent of Congress to treat as statutory hybrid plans generally only those defined benefit plans that either express the accumulated benefit as a current single-sum dollar amount or that provide for adjustments such that the participant's benefit at normal retirement age is less than that of a similarly situated, younger individual who is or could be a participant. This is because a defined benefit plan that expresses the accumulated benefit as a single-sum dollar amount at normal retirement age (and that does not provide a larger benefit to the participant than to a similarly situated, older participant) is identical to a traditional defined benefit plan for age discrimination purposes, and differs in substance from a traditional defined benefit plan only because the benefit at normal retirement age is expressed as a single-sum dollar amount rather than as an annuity.

Under these rules, a defined benefit plan that expresses the accumulated benefit as a single-sum dollar amount can be designed to express that accumulated benefit as either a current single-sum dollar amount or a single-sum dollar amount at normal retirement age. In the former case, the formula would be a lump sum-based benefit formula, and therefore would be eligible for the relief of section 411(a)(13)(A) (and subject to the rules of sections 411(a)(13)(B) and 411(b)(5)(B)). In the latter case, the formula would not be a lump sum-based benefit formula, and therefore would not be eligible for the relief of section 411(a)(13)(A).

Because a formula that expresses the accumulated benefit as a single-sum dollar amount at normal retirement age is not eligible for the relief of section 411(a)(13)(A), the accrued benefit under such a formula is often determined under the terms of the plan by applying section 417(e) factors to the single-sum dollar amount. The rules of sections 411(a)(13)(B) and 411(b)(5)(B) would generally not apply to such a formula (unless it is treated under the regulations as having an effect similar to a lump sum-based benefit formula). Instead, all of the rules that apply to defined benefit formulas that are not statutory hybrid benefit formulas would apply to such a formula. For example, if a defined benefit plan is amended to change the benefit formula under the plan to a formula that expresses the accumulated benefit as a single-sum dollar amount at normal retirement age (and the formula does not fall within the definition of a benefit formula with an effect similar to a lump sum-based benefit formula), the amendment is not subject to the rules that apply with respect to a conversion amendment under section

411(b)(5)(B)(ii). Furthermore, the mere existence of an early retirement subsidy that meets applicable rules would not affect this determination.

II. *Section 411(b)(1): Special rules with respect to variable interest crediting rates*

The 2010 proposed regulations contain a special rule regarding the application of the 133⅓ percent rule of section 411(b)(1)(B)[3] to a statutory hybrid plan that adjusts benefits using a variable interest crediting rate that can potentially be negative in any given year. Under this rule, for plan years that begin on or after January 1, 2012, a plan that determines any portion of the participant's accrued benefit pursuant to a statutory hybrid benefit formula (as defined in § 1.411(a)(13)–1(d)(4)) with a variable interest crediting rate that was negative for the prior plan year would not be treated as failing to satisfy the requirements of the 133⅓ percent rule for the current plan year merely because the section 411(b)(1)(B) backloading calculation is performed assuming that the variable rate is zero for the current plan year and all future plan years.

One commenter on the 2010 proposed regulations suggested that a special rule under the 133⅓ percent rule of section 411(b)(1)(B) should not be provided for variable interest crediting rates that can potentially be negative. Other commenters suggested that the interest crediting rate to be used for purposes of the 133⅓ percent rule in the case of a variable interest crediting rate that can potentially be negative should be assumed to be a reasonable rate of return (such as, for example a long-term average of the rate of return), regardless of the actual rate of return provided as of the current year. However, this would be inconsistent with section 411(b)(1)(B)(iv), which provides that for purposes of the 133⅓ percent rule all "relevant factors used to compute benefits shall be treated as remaining constant as of the current year for all years after the current year."

The special rule in the 2010 proposed regulations provides for the use of an assumed interest crediting rate other than the interest crediting rate used to compute benefits as of the current year only to the extent necessary to permit a statutory hybrid plan to use an interest crediting rate that can potentially be negative. Without such a rule, a statutory hybrid plan that uses a variable interest crediting rate would not satisfy the 133⅓ percent rule of section 411(b)(1)(B) if the variable interest crediting rate as of the current year is negative, even if the plan does not provide for principal credits (sometimes referred to as pay credits) that are an increasing percentage of pay with increasing years or service. The preservation of capital rule of section 411(b)(5)(B)(i)(II) provides that interest crediting rates under a statutory hybrid plan cannot result in the benefit provided being less than the sum of principal credits. Thus, Congress contemplated a statutory hybrid plan's use of a variable interest crediting rate that can potentially be negative. Accordingly, the special rule is finalized as proposed, except that the rule has been modified to permit a taxpayer to elect to apply it at an earlier date (so that the rule is applicable for plan years that begin on or after January 1, 2012, or an earlier date as elected by the taxpayer).

III. *Section 411(b)(5): Special age discrimination rules, including rules with respect to the market rate of return limitation*

A. *Section 411(b)(5) age discrimination safe harbor*

Pursuant to section 411(b)(5)(A), the 2010 final regulations provide that a plan is not treated as failing to meet the age discrimination requirements of section 411(b)(1)(H)(i) with respect to an individual who is or could be a participant if, as of any date, the accumulated benefit of the individual would not be less than the accumulated benefit of any similarly situated, younger individual who is or could be a participant. In general, this safe harbor is available only if the accumulated benefits being compared are expressed under only one type of formula (that is, cash balance formulas, PEP formulas, or annuities payable at normal retirement age). These regulations clarify that the age discrimination safe harbor for cash balance formulas and PEP formulas under section 411(b)(5) applies only for formulas that are lump sum-based benefit formulas.[4]

Under the 2010 final regulations, the safe harbor is available with respect to a participant in the case of a plan that determines some or all participants' benefits as the sum-of, greater-of, or choice-of two or more types of formulas only if the participant's benefit under the plan is not less valuable than the benefit of a similarly situated, younger individual who is or could be a participant in the plan. In order to clarify that certain limitations on benefits (such as those that are required in order to comply with section 415) would not necessarily preclude a plan from satisfying the age discrimination safe harbor, these regulations extend the application of the safe harbor so that the safe harbor is also available to a plan that expresses a participant's accumulated benefit as the lesser of benefits under two or more formulas. In addition, the regulations under section 411(a)(13) have been revised to clarify that, in the case of lesser-of formulas, the relief of section 411(a)(13)(A) applies only to benefits determined under a cash balance or PEP formula, and to provide for a special rule with respect to the application of the limitation on benefits under section 415(b) to a lump sum-based benefit formula.

Section 411(b)(5)(A)(iii) provides for a disregard of the subsidized portion of an early retirement benefit for purposes of the section 411(b)(5) age discrimination safe harbor. This is similar to the disregard of the subsidized portion of an early retirement benefit that applies under section 411(b)(1)(H)(iv) for purposes of the general age discrimination test of section 411(b)(1)(H). The 2010 final regulations provided certain guidance as to what constitutes the subsidized portion of an early retirement benefit for purposes of the section 411(b)(5) age discrimination safe harbor. These final regulations revise and clarify such guidance. In particular, in or-

[3]The 133 1/3 percent rule is the accrual rule most commonly used by statutory hybrid plans to satisfy the accrual rules of section 411(b)(1).

[4]Because the definition of lump sum-based benefit formula requires the benefit to be expressed under the terms of the plan as a cash balance formula or PEP formula, the existing language in these safe harbors that the benefit be expressed under the terms of the plan as a cash balance formula or PEP formula has been eliminated as redundant.

der to facilitate phased retirement, these final regulations remove the requirement that a subsidized portion of an early retirement benefit must be contingent on a participant's severance from employment. In addition, these final regulations provide that an early retirement benefit includes a subsidized portion only if it provides a higher actuarial present value on account of commencement before normal retirement age. These final regulations also provide for a disregard of the subsidized portion of an early retirement benefit for purposes of the special age discrimination test under section 411(b)(5)(E) that applies for indexed benefits.

However, these final regulations provide that, for plan years that begin on or after January 1, 2016, if the annual benefit payable before normal retirement age is greater for a participant than the annual benefit under the corresponding form of benefit for any similarly situated, older individual who is or could be a participant and who is currently at or before normal retirement age, then that excess is not part of the subsidized portion of an early retirement benefit and, accordingly, is not disregarded for age discrimination purposes. Thus, if more than a subsidized portion of an early retirement benefit is provided to a participant, that additional benefit is not disregarded for purposes of the section 411(b)(5) age discrimination safe harbor (and, as a result, the safe harbor typically would not be satisfied). For purposes of determining whether the annual benefit payable before normal retirement age is greater for a participant than the annual benefit under the corresponding form of benefit for any similarly situated, older individual who is or could be a participant, social security leveling options and social security supplements are disregarded. In addition, a plan is not treated as providing a greater annual benefit to a participant than to a similarly situated, older individual who is or could be a participant merely because the reduction (based on actuarial equivalence, using reasonable actuarial assumptions) in the amount of an annuity to reflect a survivor benefit is smaller for the participant than for a similarly situated, older individual who is or could be a participant.

B. *Conversion amendments*

The 2010 final regulations provide that a participant in a defined benefit plan whose benefits are affected by an amendment that converts the benefit formula under the plan from a formula that is not a statutory hybrid benefit formula to a statutory hybrid benefit formula (conversion amendment) generally must be provided with a benefit after the conversion that, in accordance with the requirements of section 411(b)(5)(B)(ii), is at least equal to the sum of benefits accrued through the date of conversion and benefits earned after the conversion, with no permitted interaction between the two portions. The 2010 final regulations provide for an alternative method of satisfying the conversion protection requirements that applies if an opening hypothetical account balance or opening accumulated percentage of the participant's final average compensation is established at the time of the conversion and the plan provides for separate calculation of (1) the benefit attributable to the opening hypothetical account balance (including interest credits attributable thereto) or attributable to the opening accumulated percentage of the participant's final average compensation and (2) the benefit attributable to post-conversion service under the post-conversion benefit formula. Under this alternative, the plan must provide that, when a participant commences benefits, the participant's benefit will be increased if the benefit attributable to the opening hypothetical account or opening accumulated percentage that is payable in the particular optional form of benefit selected is less than the benefit accrued under the plan prior to the date of conversion and that was payable in the same generalized optional form of benefit (within the meaning of § 1.411(d)–3(g)(8)) at the same annuity starting date.

Several commenters requested that the regulations illustrate the application of the conversion rules for a plan that uses this alternative method of satisfying the conversion protection requirements, with respect to a participant who selects a single-sum distribution option of the participant's entire benefit under the plan after a conversion amendment. In order to respond to this request, a new example has been added to the regulations to illustrate that the participant must be provided with the benefit attributable to post-conversion service, plus the greater of the benefit attributable to the opening hypothetical account balance or the section 417(e) present value at the annuity starting date of the participant's pre-conversion benefit.

The 2010 proposed regulations included a proposed rule whereby certain plans could satisfy the conversion protection requirements by establishing an opening hypothetical account balance without a subsequent comparison of benefits at the annuity starting date. The proposed rule included a number of requirements intended to make it reasonably likely that the hypothetical account balance used to replicate the pre-conversion benefit (the opening hypothetical account balance and interest credits on that account balance) would in most, but not necessarily all, cases provide a benefit at least as large as the pre-conversion benefit for all periods after the conversion amendment.

Several commenters found the proposed rule overly burdensome, due to the many restrictions and requirements. One commenter strongly opposed any conversion alternative that could result in any participant receiving less than the sum of the benefit under the pre-conversion formula plus the benefit under the hybrid formula at the annuity starting date. The Treasury Department and the IRS agree that the proposed rule was complex and that it is not feasible to create a simple rule while also ensuring that participants cannot receive less than is required under sections 411(b)(5)(B)(ii), 411(b)(5)(B)(iii) and 411(b)(5)(B)(iv). As a result, the final regulations only permit the conversion alternative that was included in the 2010 final regulations, where an opening hypothetical account balance or opening accumulated percentage of the participant's final average compensation is established and benefits are compared at the annuity starting date. Consequently, if in reliance on the 2010 proposed regulations, a plan sponsor used the proposed rule to satisfy the conversion protection requirements for plan years that begin on or after January 1, 2012, then the plan must be amended so that distributions with an annuity starting date in a plan year that begins on or after January 1, 2016 satisfy the rules in the final regulations with respect to conversion amendments.

C. *Market rate of return*

1. *General rules with respect to crediting interest*

Pursuant to section 411(b)(5)(B), the 2010 final regulations provide that a statutory hybrid plan satisfies the requirements of section 411(b)(1)(H) prohibiting age discrimination only if the plan does not credit interest at a rate that is greater than a market rate of return. Section 411(b)(5)(B)(i)(III) gives the Secretary the authority to provide by regulation for rules governing the calculation of a market rate of return and for permissible methods of crediting interest resulting in effective rates of return that are not greater than a market rate of return.

The 2010 final regulations set forth certain requirements that apply to a statutory hybrid plan that provides for interest credits. Under these requirements, such a plan must credit interest at least annually, and the plan terms must specify how interest credits are determined, including the timing of the crediting of interest credits. In addition, the 2010 final regulations contain a list of rates that satisfy the requirement that the plan not credit interest at an effective rate that is greater than a market rate of return, while not permitting other rates.

In evaluating whether a particular rate (or combination of rates) provides an effective rate of return that is not greater than a market rate of return for purposes of inclusion on the list of permitted rates under the 2010 final and proposed regulations, the Treasury Department and the IRS considered all fixed and variable components (taking into account any minimum rate of return and the cumulative zero floor provided by the statutory preservation of capital rule). This approach was taken because of the age discrimination concerns with statutory hybrid plans that credit interest such that the effective rate of return is greater than a market rate of return (as occurs when, for example, the combination of a variable rate of return and a fixed minimum rate provides an effective rate of return that is greater than a market rate of return). In such a case, a younger participant is able to benefit from the above-market rate for a longer period — and therefore receive a more valuable benefit — than a similarly situated, older participant.

A number of commenters objected to the provision under the 2010 final regulations under which a plan that credits interest using an interest crediting rate not on the list of rates in the regulations does not satisfy the requirement that the interest crediting rate not be greater than a market rate of return. These commenters asked that the regulations provide a list of safe harbor interest crediting rates deemed to be not greater than a market rate of return for purposes of the requirements of section 411(b)(5)(B) and also permit the use of other interest crediting rates that do not exceed a market rate of return. However, this approach would require the IRS to evaluate the characteristics of an unrestricted set of interest crediting rates to determine whether the particular interest crediting rate under each plan exceeds a market rate of return. For example, a particular investment-based interest crediting rate available in the market might be so volatile that the combination of the rate and the statutory cumulative zero floor provides an effective rate of return that is greater than a market rate of return. As another example, an interest crediting rate based on an index determined with reference to current yields on bonds that are lower in quality than the bonds used to determine the third segment rate might provide a rate of return that is greater than a market rate of return because that rate of return is not adjusted downward to reflect the occurrence of defaults in those lower quality bonds. It is theoretically possible to adjust an otherwise above-market rate downward (for example, through the use of a maximum or the application of a percentage or basis points reduction applied to the variable rate of return) so that the resulting adjusted rate does not exceed a market rate of return. However, it would not be administratively feasible for the IRS to evaluate each combination of a particular variable rate of return and a minimum rate, a maximum rate, or some other type of adjustment, to determine whether the combination provides an effective rate of return that exceeds a market rate of return. Accordingly, pursuant to the authority provided under section 411(b)(5)(B)(i)(III), the regulations continue to specify which interest crediting rates (including fixed rates, variable rates, and combinations of rates) satisfy the market rate of return requirements of section 411(b)(5)(B), while not permitting other rates.[5]

Although these final regulations continue to specify which interest crediting rates satisfy the market rate of return requirement, the list of rates has been expanded to include certain additional rates not permitted under the 2010 final and proposed regulations. In order to allow for the list of permitted rates to be further expanded in the future, these final regulations include a provision that permits the Commissioner, in guidance published in the Internal Revenue Bulletin, to increase the specific interest crediting rates set forth in the regulations (such as by increasing the maximum permitted margin that can be added to one or more of the safe harbor rates, increasing the maximum permitted fixed rate, or increasing a maximum permitted annual floor). In addition, these final regulations include a provision that permits the Commissioner, in guidance published in the Internal Revenue Bulletin, to provide for additional interest crediting rates that satisfy the requirement that they not exceed a market rate of return for purposes of section 411(b)(5)(B). Thus, for example, the Commissioner could in the future, in guidance published in the Internal Revenue Bulletin, permit a plan to use an annual floor in conjunction with an investment-based rate that is reduced so that the effective rate of return does not exceed a market rate of return. Such an annual floor would allow plans using plan assets or other investment-based market rates that may be negative in some periods to assure positive annual interest credits that could be used in determining benefits and in projecting them for purposes of section 411(b)(1)(B).

2. *Use of adjusted segment rates as interest crediting rates*

The 2010 final regulations provide that each of the three segment rates described in section 430(h)(2)(C)(i), (ii) and (iii) (which are generally used for purposes of

[5]As set forth in the "Effective/Applicability Date" section of this preamble, these provisions of the regulations apply for plan years that begin on or after January 1, 2016.

applying the minimum funding requirements for single-employer defined benefit plans) is a permissible interest crediting rate under a statutory hybrid plan. Section 40211(a) of the Moving Ahead for Progress in the 21st Century Act, Public Law 112–141 (126 Stat. 405 (2012)) (MAP–21), added section 430(h)(2)(C)(iv) to the Code, generally effective for plan years beginning on or after January 1, 2012. Section 430(h)(2)(C)(iv) provides that each of the three segment rates for a plan year is adjusted as necessary to fall within a specified range that is determined based on an average of the corresponding segment rates for the 25-year period ending on September 30 of the calendar year preceding the first day of that plan year. Section 2003 of the Highway and Transportation Funding Act of 2014, Public Law 113–159 (128 Stat. 1839 (2014)) (HATFA), modified the ranges set forth in section 430(h)(2)(C)(iv).

These final regulations provide that a statutory hybrid plan is permitted to credit interest using one of the unadjusted segment rates (without regard to section 430(h)(2)(C)(iv)) or one of the adjusted segment rates (as adjusted by application of section 430(h)(2)(C)(iv)), as specified under the terms of the plan. If future interest credits with respect to principal credits that have already accrued are determined using either an adjusted or an unadjusted segment rate, then any subsequent amendment to change to another interest crediting rate with respect to those principal credits (including a change from the adjusted rate to an unadjusted segment rate, or vice versa) must satisfy the requirements of section 411(d)(6).

3. *Rate of return on plan assets or a subset of plan assets*

The 2010 final regulations include a market rate of return rule that permits indexed benefits (such as those provided under a variable annuity benefit formula) to be adjusted using the actual rate of return on the aggregate assets of the plan, if plan assets are diversified so as to minimize the volatility of returns. Similar to the 2010 proposed regulations, these final regulations extend this rule to statutory hybrid plans generally, so that a plan may credit interest under a cash balance formula using an interest crediting rate equal to the actual rate of return on the aggregate assets of the plan, if plan assets are diversified to minimize the volatility of returns.

One commenter suggested that it should be permissible to adjust a participant's benefit under a statutory hybrid benefit formula based on the rate of return on a subset of plan assets. There may be a number of reasons why a plan sponsor may find it useful to design a plan so that a participant's benefit is adjusted based on a subset of plan assets. For example, a plan sponsor may wish to credit interest based on a rate of return that differs for different groups of participants (such as using a more conservative, or less volatile, subset of plan assets for long service employees). Similarly, a plan sponsor may wish to credit interest based on a rate of return that excludes certain subsets of plan assets (for example, excluding assets associated with traditional defined benefit plan liabilities after a conversion amendment or otherwise excluding a residual subset of assets associated with liabilities for those participants whose benefits are not adjusted under the statutory hybrid benefit formula).

In order to permit these plan designs, these final regulations expand the list of permissible interest crediting rates by permitting a variable annuity benefit formula to provide adjustments (and a cash balance formula to credit interest) using the rate of return on a subset of plan assets, if certain requirements are satisfied. Specifically, these final regulations provide that an interest crediting rate equal to the actual rate of return on the assets within a specified subset of plan assets, including both positive and negative returns, is not in excess of a market rate of return if: (1) the subset of plan assets is diversified so as to minimize the volatility of returns (this requirement is satisfied if the subset of plan assets is diversified such that it would meet the diversification requirement that must be met in order for aggregate plan assets to be used as an interest crediting rate), (2) the aggregate fair market value of qualifying employer securities and qualifying employer real property (within the meaning of section 407 of ERISA) held in the subset of plan assets does not exceed 10 percent of the fair market value of the aggregate assets in the subset;[6] and (3) the fair market value of the assets within the subset of plan assets approximates the liabilities for benefits that are adjusted by reference to the rate of return on the assets within the subset, determined using reasonable actuarial assumptions. Under this rule, there can be a residual subset of plan assets for liabilities that are not adjusted by reference to a subset (such as a subset consisting of a dedicated bond portfolio designed to satisfy liabilities with respect to retirees). In addition, if other applicable requirements are satisfied, this rule would permit a plan to base adjustments on the rate of return on different subsets for different groups of participants. The regulations include examples that illustrate the use of the rate of return on a subset of plan assets as a permitted interest crediting rate.

4. *Rate of return on a RIC or other collective investments*

Like the 2010 proposed regulations, these final regulations also permit a statutory hybrid plan to credit interest using the rate of return on a regulated investment company (RIC) that meets certain standards. Specifically, these final regulations provide that an interest crediting rate is not in excess of a market rate of return if it is equal to the rate of return on a RIC, as defined in section 851, that is reasonably expected to be not significantly more volatile than the broad United States equities market or a similarly broad international equities market. For example, a RIC that has most of its assets invested in securities of issuers (including other RICs) concentrated in an industry sector or a country other than the United States generally would not meet this requirement. Likewise, a RIC that uses leverage, or that has significant investment in derivative financial products, for the purpose of achieving returns that amplify the returns of an unleveraged investment, generally would not meet this requirement. Thus, a RIC that has most of its investments concentrated in the semiconductor industry or that uses leverage in order to provide a rate of return that is twice the rate of return on the Standard & Poor's 500 index

[6]The 10 percent limitation is similar to the limitation that applies with respect to aggregate plan assets under section 407 of ERISA.

(S&P 500) would not meet this requirement. On the other hand, a RIC that has investments that track the rate of return on the S&P 500, a broad-based "small-cap" index (such as the Russell 2000 index), or a broad-based international equities index would meet this requirement. The requirement that the RIC's investments not be concentrated in an industry sector or a specific foreign country is intended to limit the volatility of the returns, as well as the risk inherent in non-diversified investments. Similarly, the requirement that the RIC not provide leveraged returns is intended to limit the volatility of the returns provided. Subject to these requirements, the rule is intended to provide plan sponsors with greater flexibility in choosing a permissible rate of return than would be provided if the regulations were to list particular RICs or indices that satisfy the market rate of return requirement.

Several commenters suggested that it should be permissible for a statutory hybrid plan to credit interest using the rate of return on any investment available in the plan sponsor's defined contribution plan. Because the combination of a rate of return on an investment available in the plan sponsor's defined contribution plan and the statutory cumulative zero floor may provide an effective rate of return that is greater than a market rate of return, these final regulations do not provide that the rate of return on an investment is a permissible interest crediting rate merely because the investment is available in the plan sponsor's defined contribution plan. However, a subset of plan assets of a statutory hybrid plan could be comprised of investments that are options under the plan sponsor's defined contribution plan (which could be owned through a collective investment vehicle). In such a case, if the requirements set forth earlier are satisfied with respect to that subset, the rate of return on that subset would be a permissible interest crediting rate. In addition, if an investment available in the plan sponsor's defined contribution plan is a RIC that meets the requirements of the preceding paragraph, the rate of return on that RIC would also be a permissible interest crediting rate.

5. *Permitted fixed rate*

Section 411(b)(5)(B)(i)(III) authorizes the Treasury Department to issue regulations permitting a fixed rate of interest under the rules relating to a market rate of return. However, reconciling a plan's ability to provide a fixed interest crediting rate with the requirement under section 411(b)(5)(B)(i)(I) that an interest crediting rate "*for any plan year* shall be at a rate which is not greater than a market rate of return" [emphasis added] presents unique challenges because, by definition, fixed rates do not adjust with the market. As a result, the use of any fixed rate will result in an interest crediting rate that is above a then-current market rate of interest during any period in which the current market rate falls below the fixed rate.

In light of this fact, the Treasury Department and the IRS believe that, in order to satisfy the market rate of return requirement, any fixed interest crediting rate allowed under the rules must not be expected to exceed future market rates of interest, except infrequently, by small amounts, and for limited durations. Prior to the publication of the 2010 proposed regulations, the Treasury Department and the IRS modeled the difference between account balances credited with interest credits determined using various fixed interest rates and account balances credited with interest credits determined using long-term investment grade corporate bond yields, based on a stochastic distribution of those yields that reflects the historical distribution of those yields. Based on that modeling, a maximum fixed interest crediting rate of 5% per year was included in the proposed regulations.

This analysis was undertaken again prior to the publication of these regulations, using additional historical data. Based on the additional historical data, the Treasury Department and the IRS have determined that a fixed interest crediting rate of up to 6 percent satisfies these criteria and that any higher fixed rate would result in an effective rate of return that is in excess of a market rate of return. In addition to satisfying the market rate of return requirements, a fixed 6 percent rate of interest is deemed to be not in excess of the third segment rate described in section 417(e)(3)(D) or 430(h)(2)(C)(iii) (and, therefore, a plan that uses such a rate is permitted to use the special rule described in section III.E of this preamble to switch to the third segment rate without providing section 411(d)(6) protection).

6. *Permitted annual and cumulative floors*

As part of the historical modeling of rates done prior to the publication of the 2010 proposed regulations, the Treasury Department and the IRS modeled the historical distribution of rates of interest on long-term investment grade corporate bonds to determine the additional value added by various fixed floors used in conjunction with these rates. Based on this modeling, the 2010 proposed regulations would have provided that a fixed floor up to 4 percent was permissible in connection with any of the permissible bond-based interest crediting rates. Several commenters requested that the fixed floor used in conjunction with the bond-based rates be increased by at least 100 basis points. Prior to the publication of these regulations, the Treasury Department and the IRS undertook the same analysis as was undertaken prior to the publication of the 2010 proposed regulations, using additional historical data. In addition, the Treasury Department and the IRS modeled the historical distribution of the 30-year Treasury rate with fixed floors of various values compared to the historical distribution of rates of interest on long-term investment grade corporate bonds. The rates permitted under Notice 96–8 ("Notice 96–8 rates"), including the government bond-based rates such as the 30-year Treasury rate, are generally expected to be lower than the rate of interest on long-term investment grade corporate bonds. As a result, the annual floor used in conjunction with the Notice 96–8 rates can be increased to some extent without adding so much additional value that the effective rate of return is greater than a market rate of return. Accordingly, the final regulations provide that it is permissible for a plan to utilize an annual floor of up to 5 percent in conjunction with any of the Notice 96–8 rates.[7] Like the 2010 proposed regulations, these regulations continue to provide that a plan can utilize

[7]These regulations conform the names of the government bond-based rates that are permitted to be used pursuant to this rule to the names of the rates set forth in Notice 96–8.

an annual floor of up to 4 percent in conjunction with the third segment rate (the rate of interest on long-term investment grade corporate bonds), or in conjunction with the first or second segment rates.

In contrast, because of the volatility of a rate of return that reflects changes in the price level of underlying investments ("investment-based rate"), adding an annual floor to an investment-based rate often provides an effective rate of return on a cumulative basis that far exceeds the rate of return provided by the investment-based rate without such a floor. Also, commenters on both the 2007 proposed regulations and the 2010 proposed regulations generally did not request that such an annual floor be permitted. Accordingly, the final regulations do not allow the use of an annual floor in conjunction with any of the permissible investment-based rates (i.e., the rate of return on plan assets, a subset of plan assets, or a RIC).

On the other hand, if, instead of applying a floor on each year's rate of return, a cumulative floor is applied to an investment-based rate, the effective rate of return is not necessarily substantially greater than the rate of return provided without the floor. Specifically, the Treasury Department and the IRS have determined that, based on the modeling of long-term historical returns, a 3 percent floor that applies cumulatively (in the aggregate from the date of each principal credit until the annuity starting date, without a floor on the rate of return provided in any interim period) could be combined with a permissible investment-based rate (or any other permissible rate), without increasing the effective rate of return to such an extent that the effective rate of return would be in excess of a market rate of return. As a result, like the 2010 proposed regulations, the regulations provide that a plan that determines interest credits using any particular interest crediting rate that satisfies the market rate of return limitation does not provide an effective interest crediting rate in excess of a market rate of return merely because the plan provides that the participant's benefit, as of the participant's annuity starting date, is equal to the greater of the benefit determined using the interest crediting rate and the benefit determined as if the plan had used a fixed annual interest crediting rate equal to 3 percent (or a lower rate) for all principal credits that are made during the guarantee period. For this purpose, the guarantee period is the prospective period that begins on the date the cumulative floor begins to apply to the participant's benefit and that ends on the date on which that cumulative floor ceases to apply to the participant's benefit.

These regulations provide that the determination of the amount payable pursuant to the guarantee provided by any cumulative floor with respect to the participant's benefit is made only as of an annuity starting date on which a distribution of the participant's entire benefit as of that date under the plan's statutory hybrid benefit formula commences. These final regulations provide special rules in the case of a participant who has multiple annuity starting dates, in order to ensure that prior annuity starting dates are taken into account in determining the guarantee provided by a cumulative floor. These special rules in the case of a participant who has multiple annuity starting dates are largely substantively unchanged from rules in the 2010 proposed regulations, except that language has been clarified to provide that the comparison involves a comparison of the accumulated benefit to which the guarantee applies to the sum of principal credits to which the guarantee applies (and to conform to similar changes made to the rules with respect to the application of the preservation of capital requirement to a participant who has multiple annuity starting dates, as described later in section II.C.8 of this preamble, except that the new special rule for participants with 5 or more 1-year breaks in service applies only to the preservation of capital requirement).

Variable Rate	Maximum Permitted Floor
Notice 96–8 rate (for example, the yield on 30-year Treasury Constant Maturities)	5 percent annual
1st, 2nd, or 3rd segment rate	4 percent annual
Investment-based rate (for example, the rate of return on aggregate plan assets)	3 percent cumulative

7. *Permitted margins on government bond-based rates*

A number of commenters suggested that the permitted margins used in conjunction with the permitted government bond-based interest crediting rates be increased to make these rates more equivalent to the third segment rate. As clarified in these regulations, the permitted government bond-based rates and margins are the same as those that were permitted under Notice 96–8. These rates and margins have largely been maintained for the convenience of plan sponsors, so that a plan that has been using a Notice 96–8 rate can continue to do so.

The Treasury Department and the IRS understand that very few plans with government bond-based rates have margins in excess of those provided under Notice 96–8. Moreover, there are several methods by which a plan can credit interest based on a bond-based rate that is expected to be greater than a Notice 96–8 rate. For example, a plan that is using a Notice 96–8 rate can be amended to switch to the third segment rate for purposes of determining all future interest credits without the need to preserve the Notice 96–8 rate with respect to benefits accrued before the applicable amendment date if, on the effective date of the amendment, the third segment rate is not lower than the Notice 96–8 rate that would have applied in the absence of the amendment (and the other requirements of § 1.411(b)(5)–1(e)(3)(ii), which are described in section III.E of this preamble, are satisfied). In addition, because a plan can provide for a rate of return that is the lesser of a permitted rate and any other rate, a plan could adopt an interest crediting rate with respect to future pay credits that is the lesser of the third segment rate and a government bond-based rate described in Notice 96–8 with a margin, even if that margin exceeds the margin permitted under these final regulations.

8. *Other rules with respect to crediting interest*

Like the 2010 proposed regulations, these final regulations include a rule that provides that a plan is not treated as failing to meet the interest crediting requirements merely because the plan does not provide for interest credits on amounts distributed prior to the end of the interest crediting period. Thus, if a plan credits interest at annual or more frequent period intervals, the plan is not required to credit interest on amounts that were distributed between the dates on which interest under the plan is credited to the account balance. Also, the rule in the 2010 proposed regulations that allows plans to credit interest taking into account increases or decreases to the participant's accumulated benefit that occur during the period has been finalized as proposed.

The 2010 final regulations provide that a statutory hybrid plan does not provide an effective interest crediting rate that is in excess of a market rate of return merely because the plan determines an interest credit by applying different rates to different predetermined portions of the accumulated benefit, provided each rate would be a permissible rate if the rate applied to the entire accumulated benefit. With respect to this provision, some commenters suggested that the regulations should be explicit that a single rate that is a specified blend of multiple rates that applies to the entire cash balance account is permissible, as is applying different rates to different specified subaccounts of the cash balance account. The Treasury Department and the IRS believe that the current rule accommodates such a blended rate, since the predetermined portion to which a rate applies can either be a specified percentage of the cash balance account or a specified subaccount. As a result, the rule with respect to blended rates remains unchanged in the regulations.

These final regulations make some clarifying changes to the preservation of capital requirement that was included in the 2010 final regulations. In particular, these final regulations clarify that the preservation of capital requirement involves a comparison of the accumulated benefit to the sum of all principal credits and that the requirement is applied only as of an annuity starting date with respect to which a distribution of the participant's entire vested benefit under the plan's statutory hybrid benefit formula as of that date commences.

Like the 2010 proposed regulations, these final regulations provide special rules in the case of a participant who has multiple annuity starting dates, in order to ensure that prior annuity starting dates are taken into account in determining the amount of the guarantee provided under the preservation of capital requirement. Although the preservation of capital requirement applies only as of an annuity starting date with respect to which a distribution of the participant's entire vested benefit under the plan's statutory hybrid benefit formula as of that date commences, all prior annuity starting dates (including annuity starting dates with respect to partial distributions) are taken into account when applying the preservation of capital requirement as of that annuity starting date.

The special rules with respect to the preservation of capital requirement for a participant who has multiple annuity starting dates remain largely unchanged from the rules in the 2010 proposed regulations, except that these rules have been revised to reflect corresponding changes in the regulations that explicitly permit certain subsidies under statutory hybrid plans.

One commenter requested that the special rules with respect to the preservation of capital requirement for a participant who has multiple annuity starting dates not apply in the case of a participant who has experienced a break in service. In response to this comment, a new rule has been added to the regulations. Under this new rule of administrative convenience, a plan is permitted to provide that, in the case of a participant who receives a distribution of the entire vested benefit under the plan and thereafter completes 5 consecutive 1-year breaks in service, the preservation of capital requirement is applied without regard to the prior period of service. Thus, in the case of such a participant, the plan is permitted to provide that the preservation of capital requirement is applied disregarding the principal credits and distributions that occurred before the breaks in service. Application of this rule could result in a participant receiving a greater benefit (but never less) than would otherwise be provided without such a rule.

Because section 411(a)(13)(A) does not override the requirement that a defined benefit plan either provide an actuarial increase after normal retirement age or satisfy the requirements for suspension of benefits, a statutory hybrid plan that does not suspend benefits in accordance with section 411(a)(3)(B) will have to provide for adjustments in excess of the benefits determined using the plan's interest crediting rate if the interest crediting rate is insufficient to provide the required actuarial increases. However, without a special rule, that greater benefit could cause the market rate of return requirements to be violated. Thus, like the 2010 proposed regulations, these final regulations provide for a special rule that allows for any required adjustments after normal retirement age to be provided as interest credits without violating the market rate of return requirements.

D. *Plan termination*

Like the 2010 proposed regulations, the regulations provide special rules that apply for purposes of determining interest crediting rates and certain other plan factors under a statutory hybrid benefit formula after the plan termination date of a statutory hybrid plan, including guidance with respect to 5-year averaging of rates under section 411(b)(5)(B)(vi). The terms of a statutory hybrid plan must reflect these rules.

The regulations provide guidance as to the interest crediting rate used to determine benefits after the plan termination date. Several commenters on the 2010 proposed regulations suggested that additional guidance is needed as to the rules that apply with respect to the annuity conversion interest rates and factors that apply after the plan termination date, as well as the mortality table that is used after the plan termination date. In response to these comments, these regulations provide additional guidance as to annuity conversion rates, factors, and mortality tables.

Similar to the 2010 proposed regulations, the regulations provide that a plan satisfies the plan termination requirements only if the interest crediting rate used to determine a participant's accumulated benefit for interest crediting periods that end after the plan termination date is equal to the average of the interest rates used under the plan during the 5-year period ending on the plan termination date. Pursuant to section 411(d)(5)(B)(vi), the actual interest crediting rate (taking into account minimums, maximums, and other adjustments) used under the plan for the interest crediting period generally is used for purposes of determining the average of the interest rates. However, section 411(b)(5)(B)(vi) does not provide a rule for periods in which an investment-based rate of return, rather than a variable interest rate, is used under the plan to determine interest credits. In addition, the trailing 5-year average of an investment-based rate of return may be unreasonably high or unreasonably low and, unlike the trailing 5-year average of an interest rate, will have little, if any, correlation to the actual future investment-based rate of return. As a result, the Treasury Department and the IRS do not believe it is appropriate for the trailing 5-year average of an investment-based rate of return to be used to determine benefits after plan termination.

The 2010 proposed regulations would have substituted the third segment rate generally for interest crediting rates that are not based on interest rates. A number of commenters suggested that the substitution of the third segment rate would make plan termination unduly costly for plans that used investment-based interest crediting rates. While the future return of an investment that includes an equity component may be expected to be higher than the third segment rate, the Treasury Department and the IRS note that the third segment rate is normally higher than the rate used under defined benefit plans for other purposes, including funding, and agree that the third segment rate is inappropriately high for purposes of substituting a fixed rate of return for periods after the plan's termination date. Consistent with the statutory language of section 411(b)(5)(B)(vi)(I), the Treasury Department and the IRS continue to believe it is appropriate to substitute a rate of interest used under the plan for those periods in which an investment-based rate of return was used to determine interest credits. However, in lieu of the third segment rate, the final regulations provide that the second segment rate under section 430(h)(2)(C)(ii) (determined without regard to section 430(h)(2)(C)(iv)) for the last calendar month ending before the beginning of the interest crediting period, generally must be substituted for an investment-based rate of return that applied for that interest crediting period. For many plans, the second segment rate is close to the effective interest rate that is used for funding purposes, and thus the substitute interest rate frequently will approximate the plan's funding discount rate (without being affected by the specific plan demographics).

The regulations contain certain rules of application with respect to these plan termination rules, including rules with respect to section 411(d)(6) protected benefits. The regulations also include examples to illustrate the application of these plan termination rules. In response to a commenter's request, the regulations include an example illustrating the application of these plan termination rules in the case where the plan uses the section 417(e) segment rates for annuity conversion.

E. *Rules relating to section 411(d)(6) and interest crediting rates*

The 2010 final regulations provided that the right to interest credits in the future that are not conditioned on future service constitutes a section 411(d)(6) protected benefit. One commenter expressed concern that this rule was overbroad. In response to this comment, these final regulations clarify that the right to future interest credits determined in the manner specified under the plan and not conditioned on future service is a factor that is used to determine the participant's accrued benefit for purposes of section 411(d)(6). Thus, if a plan is amended so that it could potentially provide smaller future interest credits on the then-current accumulated benefit than would have been provided prior to the amendment, the plan must otherwise provide for increased benefits such that the potentially smaller interest credits cannot result in a smaller accrued benefit (or a smaller payment under any optional form of benefit) as of any future date than the accrued benefit (or payment under the optional form of benefit) as of the applicable amendment date. See section I.B of this preamble for a discussion of the additional rule under the regulations pursuant to which the relief of section 411(a)(13) does not permit the accumulated benefit under a lump sum-based benefit formula to be reduced in a manner that would be prohibited if that reduction were applied to the accrued benefit.

The 2010 final regulations contain a rule under which a plan is not treated as providing for smaller interest credits in the future in violation of section 411(d)(6) merely because of an amendment that changes the plan's interest crediting rate from one of the Notice 96–8 rates (or the first or second segment rates) to the third segment rate, if three requirements are satisfied. Specifically, the rule is only available if the change applies to interest credits to be credited after the effective date of the amendment, the effective date of the amendment is at least 30 days after adoption and, on the effective date of the amendment, the new interest crediting rate is not lower than the interest crediting rate that would have applied in the absence of the amendment. The 2010 final regulations do not specify how a plan with a fixed annual floor used in connection with the pre-amendment rate should account for the floor when changing to the third segment rate. These final regulations add a fourth requirement to this rule, which provides that, for plan years that begin on or after January 1, 2016, any fixed annual floor that was used in connection with the pre-amendment rate must be retained after the amendment to the maximum extent permissible under the market rate of return requirement in the final regulations. Thus, for example, if prior to the amendment a plan was using a fixed annual floor of 4.5 percent in connection with the yield on 30-year Treasury Constant Maturities, then, if the plan is amended to change the rate to the third segment rate it must provide a fixed annual floor of 4 percent.

Because section 411(d)(6) requires that a plan amendment not result in a reduction to the accrued benefit, changes in interest crediting rates would be difficult to implement without special market rate of return rules. Thus, like the 2010 proposed regulations, the regulations contain a special market rate of return rule that applies in the case of an amendment to change the plan's interest crediting rate. This rule provides that the market rate of return rule is not violated merely because the plan provides that the benefit of active participants after the interest crediting rate change can never be less than the benefit under the old rate (without future principal credits), subject to an anti-abuse rule. This rule does not extend to participants who are not active participants as of the date of amendment because such an extension would cause those participants effectively to receive a rate of return on their entire account balance that is the greater of the old and the new rate, which would be an impermissible above-market interest crediting rate under the regulations (unless the resulting greater-of rate is otherwise permitted under the regulations). These final regulations also contain a special rule that provides both section 411(d)(6) relief and relief under the market rate of return rules for changing the lookback month or stability period used to determine interest credits (for a plan using a bond-based interest crediting rate), subject to an anti-abuse rule.

A comment request that was included in the preamble to the 2010 proposed regulations asked how section 411(d)(6) applies in the case of a plan that credits interest using an interest crediting rate equal to the rate of return on a RIC if the RIC ceases to exist. Commenters generally suggested that section 411(d)(6) should be treated as satisfied in such a case if the plan sponsor replaces the RIC that ceases to exist with a RIC with similar characteristics (such as risk and expected return). The Treasury Department and the IRS generally agree with these comments. As a result, these final regulations provide for a special rule that applies in the case of a statutory hybrid plan that credits interest using an interest crediting rate equal to the rate of return on a RIC that ceases to exist, whether as a result of a name change, liquidation, or otherwise. In such a case, the plan is not treated as violating section 411(d)(6) provided that the rate of return on the successor RIC is substituted for the rate of return on the RIC that no longer exists, for purposes of crediting interest for periods after the date the RIC ceased to exist. In the case of a name change or merger of RICs, the successor RIC means the RIC that results from the name change or merger involving the RIC that no longer exists. In all other cases, the successor RIC is a RIC selected by the plan sponsor that has reasonably similar characteristics, including characteristics related to risk and rate of return, as the RIC that no longer exists.

Prior to the first day of the first plan year that begins on or after January 1, 2016, a statutory hybrid plan that uses an interest crediting rate that is not permitted under the final regulations must be amended to change to an interest crediting rate that is on the list of permitted interest crediting rates under the regulations. This is because, after that date, the final regulations set forth the list of interest crediting rates that satisfy the requirement of section 411(b)(5)(B)(i) that the plan not provide an effective rate of return that is greater than a market rate of return. However, an amendment that reduces the interest crediting rate with respect to benefits that have already accrued would ordinarily be impermissible under section 411(d)(6). A comment request that was included in the preamble to the 2010 proposed regulations solicited comments with respect to guidance needed to resolve this conflict between the market rate of return rules of section 411(b)(1)(B)(i) and the anti-cutback rules of section 411(d)(6) in order to permit a plan to change its interest crediting rate to comply with the final regulations. After consideration of the comments received, proposed regulations that would permit a plan with a noncompliant interest crediting rate to be amended so that its interest crediting rate complies with the market rate of return rules are being issued concurrently with these final regulations.

F. *Requests to introduce "self-directed investment" into statutory hybrid plans*

In response to stakeholder suggestions, the preamble of the 2010 proposed regulations requested comments as to whether a statutory hybrid plan should be able to offer participants the opportunity to choose from a menu of hypothetical investment options. If such an approach were adopted, it could introduce into defined benefit pension plans that constitute statutory hybrid plans a form of participant involvement in the selection of interest crediting rates that would be somewhat analogous to the self-directed investment practices that are typical of section 401(k) retirement savings plans. Under such an approach, participants could choose from among hypothetical investment options that would determine the interest crediting rate. The menu of hypothetical investment options might include various equity or fixed income investment alternatives, potentially including options similar to balanced or target date funds.[8] The 2010 preamble also requested comments on the plan qualification issues that might arise under such a plan design, such as the treatment of forfeitures, the application of the anti-cutback rules under section 411(d)(6), compliance with the market rate of return requirement, and other section 411(b)(5) issues. In addition, comments were specifically requested as to whether events such as the following would raise issues: (1) a participant elects to switch from one investment option to another; (2) a RIC underlying one of the investment options ceases to exist; (3) the plan is amended to eliminate an investment option; (4) a participant elects to switch from an investment option with a cumulative minimum to an investment option without a cumulative minimum (or vice versa); or (5) the plan is terminated and, pursuant to the special rules that apply upon plan termination, the interest crediting rate that applies to determine a participant's benefit after plan termination must be fixed.

Several commenters expressed serious concerns about the possibility of giving statutory hybrid plan participants the ability to choose from a menu of hypothetical investment options. These comments reflect a general concern that adding participant choice of investment options to a statutory hybrid plan would constitute a further departure of these plans from the fundamental nature of defined benefit pen-

[8]A target date investment option under a statutory hybrid plan would transition participants incrementally at certain ages from a blended rate that is more heavily equity-weighted to a rate that is more heavily weighted in fixed income.

sion plans. Underlying this general concern appears to be a view that participant choice of investment options is a practice that has developed uniquely in the context of certain types of defined contribution retirement savings vehicles (such as section 401(k) and section 403(b) plans) and is not readily reconcilable with the statutory and regulatory regime applicable to defined benefit pension plans. For example, commenters questioned the advisability of shifting retirement security risks to participants in defined benefit pension plans in a manner similar to self-directed investing in section 401(k) plans. In this regard, commenters have raised questions as to whether participants in general have the knowledge, experience, and discipline to deal as effectively as plan fiduciaries and other investment professionals with the different risk and return characteristics of various investment options and to formulate and adhere systematically to methodical investment practices and strategies (such as appropriate risk diversification and regular rebalancing).

Commenters also raised concerns regarding potential hazards for trustees and plan sponsors of statutory hybrid plans that provide investment choices to participants. Commenters suggested that if plan assets were invested to track participant elections of equity-heavy interest crediting options or frequent participant-directed investment changes that might not be prudent, section 404(c) of ERISA might not be available to limit plan fiduciary liability and help protect participants. In the alternative, concerns have been expressed that, if plan assets were invested according to a traditional defined benefit plan investment strategy not correlated with participants' elections, a well-funded plan might quickly become underfunded in a period when equity-heavy interest crediting options perform well (which could lead to additional exposure for the PBGC and put participants at risk for shortfalls in anticipated benefits).

In addition, because the interest crediting rate is part of a participant's accrued benefit and all related future interest credits are accrued at the time a participant accrues a pay credit, some commenters suggested that a change in the interest crediting rate might be treated as a plan amendment for section 411(d)(6) anti-cutback purposes (similar to rules preventing participants from waiving all or any part of their accrued benefit). This section 411(d)(6) interpretation would require preserving the prior interest crediting rate with respect to benefits previously accrued. Under this interpretation, participants would be encouraged to select one rate and subsequently change to another rate with different characteristics to achieve the greater of the two interest crediting rates. In addition, the resulting greater-of rate that is required under this section 411(d)(6) interpretation raises issues under the section 411(b)(5) rules that provide that an interest crediting rate cannot exceed a market rate of return.

Other commenters suggested that the regulations should permit statutory hybrid plans to provide for participant choice among hypothetical investment options. For example, they noted that if statutory hybrid plans were permitted to allow participant-directed investments, this plan design might be more popular among participants and employer sponsors, in an era in which adoption and retention of defined benefit plans generally have been waning. The commenters also argued that permitting investment-based rates of return in statutory hybrid plans suggests that participants should be permitted to direct the investment of their hypothetical accounts on the theory that participants should have the option to elect a less volatile investment, particularly as they near retirement, as in the case of a target date fund or managed account.

These commenters argued that a choice among investment options is dissimilar, for purposes of applying the anti-cutback rule of section 411(d)(6), to a waiver of accrued benefits (because, at the time of a change, the value of an investment dollar in any market-based investment option is the same as the value of an investment dollar in any other market-based investment option). They contended that the anti-cutback rule may protect a participant's right to choose among interest crediting measures, but would not protect the accrued benefit determined under a participant's particular choice among interest crediting measures.

Some commenters that advocated that the regulations permit a statutory hybrid plan to provide for participant choice among investment options also requested transition relief in the event that regulations do not permit this type of plan design. For example, they suggested that participant choice be permitted during the interim period between the statutory and regulatory effective dates. They also suggested that, even after the regulatory effective date, a participant in a plan that previously provided for participant choice be permitted to continue to direct the investment of the account balance credited to that participant as of the regulatory effective date and/or that anti-cutback relief be provided so that plan sponsors can move to a different method of matching investment risk to individual participant circumstances (such as basing interest crediting rates on the performance of target date funds or managed accounts, without participant choice).

Because of the significant concerns relating to the use of statutory hybrid plan designs that would permit participants to choose among a menu of investment options specified in the plan document, the Treasury Department and the IRS continue to study these issues. It is possible that the Treasury Department and the IRS will conclude that such plan designs are not permitted. In that event, it is anticipated that any statutory hybrid plans that permitted participant choice among a menu of investment options on September 18, 2014 pursuant to plan provisions that were adopted by September 18, 2014 would receive anti-cutback relief that would permit any such plans to be amended to provide for one or more appropriate alternative replacement interest crediting measures.

Some commenters raised concerns regarding whether it would be consistent with the fiduciary, disclosure, and other requirements of Title I of ERISA if a statutory hybrid plan were to permit participant choice among a menu of investment options. Concerns raised by these plan designs under Title I of ERISA are within the jurisdiction of the Secretary of Labor. See Reorganization Plan No. 4 of 1978, 5 U.S.C. App. at 672 (2006).

Effective/Applicability Dates

Except as otherwise provided, the new rules under these final regulations apply to plan years that begin on or after January 1,

2016. (The rules in these final regulations that merely clarify provisions that were included in the 2010 final regulations apply to plan years that begin on or after January 1, 2011, in accordance with the general effective/applicability date of the 2010 final regulations). In addition, these regulations amend § 1.411(b)(5)–1 to provide that § 1.411(b)(5)–1(d)(1)(iii), (d)(1)(vi) and (d)(6)(i) (which provide that the regulations set forth the list of interest crediting rates and combinations of interest crediting rates that satisfy the market rate of return requirement under section 411(b)(5)) apply to plan years that begin on or after January 1, 2016.[9]

The final regulations reflect the statutory effective dates set forth in section 701(e) of PPA '06. Pursuant to section 701(e)(1) of PPA '06, the amendments made by section 701 of PPA '06 are generally effective for periods beginning on or after June 29, 2005. However, sections 701(e)(2) through 701(e)(6) of PPA '06, as amended by WRERA '08, set forth a number of special effective/applicability date rules that are described earlier in the Background section of the preamble of these regulations.

For periods after the statutory effective date and before the regulatory effective date, the relief of sections 411(a)(13) and 411(b)(5) applies and the requirements of sections 411(a)(13) and 411(b)(5) must be satisfied. As provided in the 2010 final regulations, a plan is permitted to rely on the provisions of the final regulations for purposes of applying the relief and satisfying the requirements of sections 411(a)(13) and 411(b)(5) for periods after the statutory effective date and before the regulatory effective date. For such periods, a plan is also permitted to rely on the provisions of the 2010 proposed regulations, the 2007 proposed regulations and Notice 2007–6 for purposes of applying the relief and satisfying the requirements of sections 411(a)(13) and 411(b)(5).

The regulations should not be construed to create any inference concerning the applicable law prior to the effective dates of sections 411(a)(13) and 411(b)(5). See also section 701(d) of PPA '06. In addition, the regulations should not be construed to create any inference concerning the proper interpretation of sections 411(a)(13) and 411(b)(5) prior to the effective date of the regulations. Thus, for example, if prior to the effective date of these final regulations a plan provided an interest crediting rate that is not provided for under the final regulations, the plan's interest crediting rate for that period could nonetheless satisfy the statutory requirement that an applicable defined benefit plan not provide for interest credits (or equivalent amounts) for any plan year at an effective rate that is greater than a market rate of return.

Special Analyses

It has been determined that these regulations are 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 regulation does 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, the proposed regulations preceding these final regulations were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal authors of these regulations are Neil S. Sandhu and Linda S. F. Marshall, Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and the Treasury Department participated in the development of these regulations.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is 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 1.411(a)(13)–1 is amended by:

1. Revising paragraphs (b)(2), (b)(3), (b)(4), (d)(3)(i), (d)(4)(ii)(A), (d)(4)(ii)(C), (d)(6), and (e)(2)(ii).

2. Adding paragraph (d)(4)(ii)(E).

The revisions and addition read as follows:

§ 1.411(a)(13)–1 Statutory hybrid plans.

* * * * *

(b) * * *

(2) *General rules with respect to current account balance or current value*—(i) *Benefit after normal retirement age*. The relief of section 411(a)(13) does not override the requirement for a plan that, with respect to a participant with an annuity starting date after normal retirement age, the plan either provide an actuarial increase after normal retirement age or satisfy the requirements for suspension of benefits under section 411(a)(3)(B). Accordingly, with respect to such a participant, a plan with a lump sum based benefit formula violates the requirements of section 411(a) if the balance of the hypothetical account or the value of the accumulated percentage of the participant's final average compensation is not increased sufficiently to satisfy the requirements of section 411(a)(2) for distributions commencing after normal retirement age, unless the plan suspends benefits in accordance with section 411(a)(3)(B).

(ii) *Reductions limited*. The relief of section 411(a)(13) does not permit the accumulated benefit under a lump sum-based benefit formula to be reduced in a manner that would be prohibited if that reduction were applied to the accrued benefit. Accordingly, the only reductions that can apply to the balance of the hypothetical account or accumulated percentage of the participant's final average compensation are reductions as a result of—

[9]The 2010 final regulations provide that these particular provisions apply to plan years that begin on or after January 1, 2012. The intention to delay the effective/applicability date of these provisions was announced in Notice 2011–85 and Notice 2012–61. Notice 2012–61 announced that these provisions would not be effective for plan years beginning before January 1, 2014.

(A) Benefit payments;

(B) Qualified domestic relations orders under section 414(p);

(C) Forfeitures that are permitted under section 411(a) (such as charges for providing a qualified preretirement survivor annuity);

(D) Amendments that would reduce the accrued benefit but that are permitted under section 411(d)(6);

(E) Adjustments resulting in a decrease in the balance of the hypothetical account due to the application of interest credits (as defined in § 1.411(b)(5)–1(d)(1)(ii)(A)) that are negative for an interest crediting period;

(F) In the case of a formula that expresses the accumulated benefit as an accumulated percentage of the participant's final average compensation, adjustments resulting in a decrease in the dollar amount of the accumulated percentage of the participant's final average compensation—

(*1*) Due to a decrease in the dollar amount of the participant's final average compensation; or

(*2*) Due to an increase in the integration level, under a formula that is integrated with Social Security (for example, as a result of an increase in the Social Security taxable wage base or in Social Security covered compensation); or

(G) Other reductions to the extent provided by the Commissioner in revenue rulings, notices, or other guidance published in the Internal Revenue Bulletin (see § 601.601(d)(2)(ii)(*b*)).

(3) *Payment of benefits based on current account balance or current value*—(i) *Optional forms that are actuarially equivalent*. With respect to the benefits under a lump sum-based benefit formula, the relief of paragraph (b)(1) of this section applies to an optional form of benefit that is determined as of the annuity starting date as the actuarial equivalent, using reasonable actuarial assumptions, of the then-current balance of a hypothetical account maintained for the participant or the then-current value of an accumulated percentage of the participant's final average compensation.

(ii) *Optional forms that are subsidized*. With respect to the benefits under a lump sum-based benefit formula, if an optional form of benefit is payable in an amount that is greater than the actuarial equivalent, determined using reasonable actuarial assumptions, of the then-current balance of a hypothetical account maintained for the participant or the then-current value of an accumulated percentage of the participant's final average compensation, then the plan satisfies the requirements of sections 411(a)(2), 411(a)(11), 411(c) and 417(e) with respect to the amount of that optional form of benefit. However, see § 1.411(b)(5)–1(b)(1)(iii) for rules relating to early retirement subsidies.

(iii) *Optional forms that are less valuable*. Except as otherwise provided in paragraph (b)(4)(i) of this section, if an optional form of benefit is not at least the actuarial equivalent, using reasonable actuarial assumptions, of the then-current balance of a hypothetical account maintained for the participant or the then-current value of an accumulated percentage of the participant's final average compensation, then the relief under section 411(a)(13) (permitting a plan to treat the account balance or accumulated percentage as the actuarial equivalent of the portion of the accrued benefit determined under the lump sum-based benefit formula) does not apply in determining whether the optional form of benefit is the actuarial equivalent of the portion of the accrued benefit determined under the lump sum-based benefit formula. As a result, payment of that optional form of benefit must satisfy the rules applicable to payment of the accrued benefit generally under a defined benefit plan (without regard to the special rules of section 411(a)(13)(A) and paragraph (b)(1) of this section), including the requirements of section 411(a)(2) and, for optional forms subject to the minimum present value requirements of section 417(e)(3), those minimum present value requirements.

(4) *Rules of application*—(i) *Relief applies on proportionate basis with respect to payment of only a portion of the benefit under a lump sum-based benefit formula*. The relief of paragraph (b)(1) of this section applies on a proportionate basis to a payment of a portion of the benefit under a lump sum-based benefit formula, such as a payment of a specified dollar amount or percentage of the then-current balance of a hypothetical account maintained for the participant or then-current value of an accumulated percentage of the participant's final average compensation. Thus, for example, if a plan that expresses the participant's entire accumulated benefit as the balance of a hypothetical account distributes 40 percent of the participant's then-current hypothetical account balance in a single payment, the plan is treated as satisfying the requirements of section 411(a) and the minimum present value rules of section 417(e) with respect to 40 percent of the participant's then-current accrued benefit.

(ii) *Relief applies only to portion of benefit determined under lump sum-based benefit formula*. The relief of paragraph (b)(1) of this section generally applies only to the portion of the participant's benefit that is determined under a lump sum-based benefit formula and generally does not apply to any portion of the participant's benefit that is determined under a formula that is not a lump sum-based benefit formula. The following rules apply for purposes of satisfying section 417(e):

(A) *"Greater-of" formulas*. If the participant's accrued benefit equals the greater of the accrued benefit under a lump sum-based benefit formula and the accrued benefit under another formula that is not a lump-sum based benefit formula, a single-sum payment of the participant's entire benefit must be no less than the greater of the then-current accumulated benefit under the lump sum-based benefit formula and the present value, determined in accordance with section 417(e), of the benefit under the other formula. For example, assume that the accrued benefit under a plan is determined as the greater of the accrued benefit attributable to the balance of a hypothetical account and the accrued benefit equal to a pro rata portion of a normal retirement benefit determined by projecting the hypothetical account balance (including future principal and interest credits) to normal retirement age. In such a case, a single-sum payment of the participant's entire benefit must be no less than the greater of the then-current balance of the hypothetical account and the present value, determined in accordance with section 417(e), of the pro rata benefit determined by projecting the hypothetical account balance to normal retirement age.

(B) *"Sum-of" formulas*. If the participant's accrued benefit equals the sum of the accrued benefit under a lump sum-based benefit formula and the accrued benefit under another formula that is not a lump-sum based benefit formula, a single-sum payment of the participant's entire benefit must be no less than the sum of the then-current accumulated benefit under the lump sum-based benefit formula and the present value, determined in accordance with section 417(e), of the benefit under the other formula. For example, assume that the accrued benefit under a plan is determined as the sum of the accrued benefit attributable to the balance of a hypothetical account and the accrued benefit equal to the excess of the benefit under another formula over the benefit under the hypothetical account formula. In such a case, a single-sum payment of the participant's entire benefit must be no less than the sum of the then-current balance of the hypothetical account and the present value, determined in accordance with section 417(e), of the excess of the benefit under the other formula over the benefit under the hypothetical account formula.

(C) *"Lesser-of" formulas*. If the participant's accrued benefit equals the lesser of the accrued benefit under a lump sum-based benefit formula and the accrued benefit under another formula that is not a lump-sum based benefit formula, a single-sum payment of the participant's entire benefit must be no less than the lesser of the then-current accumulated benefit under the lump sum-based benefit formula and the present value, determined in accordance with section 417(e), of the benefit under the other formula. For example, assume that the accrued benefit under a plan is determined as the accrued benefit attributable to the balance of a hypothetical account, but no greater than an accrued benefit payable at normal retirement age in the form of a straight life annuity of $100,000 per year. In such a case, a single-sum payment of the participant's entire benefit must be no less than the lesser of the then-current balance of the hypothetical account and the present value, determined in accordance with section 417(e), of a benefit payable at normal retirement age in the form of a straight life annuity of $100,000 per year. If the formula that is not a lump sum-based benefit formula is the maximum annual benefit described in section 415(b), then the single-sum payment of the participant's entire benefit must not exceed the then-current accumulated benefit under the lump sum-based benefit formula.

* * * * *

(d) * * *

(3) *Lump sum-based benefit formula*—(i) *In general*. A lump sum-based benefit formula means a benefit formula used to determine all or any part of a participant's accumulated benefit under a defined benefit plan under which the accumulated benefit provided under the formula is expressed as the current balance of a hypothetical account maintained for the participant or as the current value of an accumulated percentage of the participant's final average compensation. A benefit formula is expressed as the current balance of a hypothetical account maintained for the participant if it is expressed as a current single-sum dollar amount equal to that balance. A benefit formula is expressed as the current value of an accumulated percentage of the participant's final average compensation if it is expressed as a current single-sum dollar amount equal to a percentage of the participant's final average compensation or, for plan years that begin on or after January 1, 2016 (or any earlier date as elected by the taxpayer), a percentage of the participant's highest average compensation (regardless of whether the plan applies a limitation on the past period for which compensation is taken into account in determining highest average compensation). Whether a benefit formula is a lump sum-based benefit formula is determined based on how the accumulated benefit of a participant is expressed under the terms of the plan, and does not depend on whether the plan provides an optional form of benefit in the form of a single-sum payment. However, for plan years that begin on or after January 1, 2016, a benefit formula does not constitute a lump sum-based benefit formula unless a distribution of the benefits under that formula in the form of a single-sum payment equals the accumulated benefit under that formula (except to the extent the single-sum payment is greater to satisfy the requirements of section 411(d)(6)). In addition, for plan years that begin on or after January 1, 2016, a benefit formula does not constitute a lump sum-based benefit formula unless the portion of the participant's accrued benefit that is determined under that formula and the then-current balance of the hypothetical account or the then-current value of the accumulated percentage of the participant's final average compensation are actuarially equivalent (determined using reasonable actuarial assumptions) either—

(A) Upon attainment of normal retirement age; or

(B) At the annuity starting date for a distribution with respect to that portion.

* * * * *

(4) * * *

(ii) *Effect similar to a lump sum-based benefit formula*—(A) *In general*. Except as provided in paragraphs (d)(4)(ii)(B) through (E) of this section, a benefit formula under a defined benefit plan that is not a lump sum-based benefit formula has an effect similar to a lump sum-based benefit formula if the formula provides that a participant's accumulated benefit is expressed as a benefit that includes the right to adjustments (including a formula that provides for indexed benefits under § 1.411(b)(5)–1(b)(2)) for a future period and the total dollar amount of those adjustments is reasonably expected to be smaller for the participant than for any similarly situated, younger individual (within the meaning of § 1.411(b)(5)–1(b)(5)) who is or could be a participant in the plan. For this purpose, the right to adjustments for a future period means, for plan years that begin on or after January 1, 2016, the right to any changes in the dollar amount of benefits over time, regardless of whether those adjustments are denominated as interest credits. A benefit formula that does not include adjustments for any future period is treated as a formula with an effect similar to a lump sum-based benefit formula if the formula would be described in this paragraph (d)(4)(ii)(A) except for the fact that the adjustments are provided pursuant to a pattern of repeated plan amendments. See § 1.411(d)–4, A–1(c)(1).

* * * * *

(C) *Exception for certain variable annuity benefit formulas*. If a variable annuity benefit formula adjusts benefits by reference to the difference between a rate of return on plan assets (or specified market indices) and a specified assumed interest rate of 5 percent or higher, then the variable annuity benefit formula is not treated as being reasonably expected to provide a smaller total dollar amount of future adjustments for the participant than for any similarly situated, younger individual who is or could be a participant in the plan, and thus such a variable annuity benefit formula does not have an effect similar to a lump sum-based benefit formula. For plan years that begin on or after January 1, 2016 (or any earlier date as elected by the taxpayer), the rate of return on plan assets (or specified market index) by reference to which the benefit formula adjusts must be a rate of return described in § 1.411(b)(5)–1(d)(5) (which includes, in the case of a benefit formula determined with reference to an annuity contract for an employee issued by an insurance company licensed under the laws of a State, the rate of return on the market index specified under that contract).

* * * * *

(E) *Exception for certain actuarial reductions for early commencement under traditional formula*. A defined benefit formula is not treated as having an effect similar to a lump sum-based benefit formula with respect to a participant merely because the formula provides for a reduction in the benefit payable at early retirement due to early commencement (with the result that the benefit payable at normal retirement age is greater than the benefit payable at early retirement), provided that the benefit payable at normal retirement age to the participant cannot be less than the benefit payable at normal retirement age to any similarly situated, younger individual who is or could be a participant in the plan. Thus, for example, a plan that provides a benefit equal to 1 percent of final average pay per year of service, payable as a life annuity at normal retirement age, is not treated as having an effect similar to a lump sum-based benefit formula by reason of an actuarial reduction in the benefit payable under the plan for early commencement.

* * * * *

(6) *Variable annuity benefit formula*. A variable annuity benefit formula means any benefit formula under a defined benefit plan which provides that the amount payable is periodically adjusted by reference to the difference between a rate of return and a specified assumed interest rate.

* * * * *

(e) * * *

(2) * * *

(ii) *Special effective date*. Paragraphs (b)(2), (b)(3) and (b)(4) of this section apply to plan years that begin on or after January 1, 2016.

* * * * *

Par. 3. Section 1.411(b)–1 is amended by adding paragraph (b)(2)(ii)(G) and adding and reserving paragraph (b)(2)(ii)(H) to read as follows:

§ 1.411(b)–1 Accrued benefit requirements.

* * * * *

(b) * * *

(2) * * *

(ii) * * *

(G) *Variable interest crediting rate under a statutory hybrid benefit formula*. For plan years that begin on or after January 1, 2012 (or an earlier date as elected by the taxpayer), a plan that determines any portion of the participant's accrued benefit pursuant to a statutory hybrid benefit formula (as defined in § 1.411(a)(13)–1(d)(4)) that utilizes an interest crediting rate described in § 1.411(b)(5)–1(d) that is a variable rate that was less than zero for the prior plan year is not treated as failing to satisfy the requirements of paragraph (b)(2) of this section for the current plan year merely because the plan assumes for purposes of paragraph (b)(2) of this section that the variable rate is zero for the current plan year and all future plan years.

(H) *Special rule for multiple formulas*. [Reserved]

* * * * *

Par. 4. Section 1.411(b)(5)–1 is amended by:

1. Revising paragraphs (b)(1)(i)(B), (b)(1)(i)(C), (b)(1)(ii), (b)(1)(iii), and (b)(2)(i).

2. Revising paragraph (c)(3)(i).

3. Removing paragraph (c)(3)(iii).

4. Adding *Example 8* to paragraph (c)(5).

5. Revising paragraphs (d)(1)(iv)(D), (d)(2)(i), (d)(2)(ii), (d)(3), (d)(4)(ii), (d)(4)(iv), (d)(5)(ii), (d)(5)(iv), (d)(6)(ii), (d)(6)(iii), (e)(2), (e)(3)(ii)(B), (e)(3)(ii)(C), (e)(3)(iii), (e)(4), and (f)(2)(i)(B).

6. Adding paragraphs (d)(1)(viii), (d)(4)(v), (e)(3)(ii)(D), (e)(3)(iv), (e)(3)(v), and (e)(5).

7. Revising the last sentence of paragraph (d)(1)(v).

8. Revising the first and fourth sentences of paragraph (e)(3)(i).

The revisions and additions read as follows:

§ 1.411(b)(5)–1 Reduction in rate of benefit accrual under a defined benefit plan.

* * * * *

(b) * * *

(1) * * *

(i) * * *

(B) The current balance of a hypothetical account maintained for the participant if the accumulated benefit of the participant is the current balance of a hypothetical account.

(C) The current value of an accumulated percentage of the participant's final average compensation if the accumulated benefit of the participant is the current value of an accumulated percentage of the participant's final average compensation.

(ii) *Benefit formulas for comparison*—(A) *In general*. Except as provided in paragraphs (b)(1)(ii)(B), (C), (D) and (E) of this section, the safe harbor provided by section 411(b)(5)(A) and paragraph (b)(1)(i) of this section is available only with respect to a participant if the participant's accumulated benefit under the plan is expressed in terms of only one safe-harbor formula measure and no similarly situated, younger individual who is or could be a participant has an accumulated benefit that is expressed in terms of any measure other than that same safe-harbor formula measure. Thus, for example, if a plan provides that the accumulated benefit of participants who are age 55 or older is expressed under the terms of the plan as a life annuity payable at normal retirement age (or current age if later) as described in paragraph (b)(1)(i)(A) of this section and the plan provides that the accumulated benefit of participants who are younger than age 55 is expressed as the current balance of a hypothetical account as described in paragraph (b)(1)(i)(B) of this section, then the safe harbor described in section 411(b)(5)(A) and paragraph (b)(1)(i) of this section does not apply to individuals who are or could be participants and who are age 55 or older.

(B) *Sum-of benefit formulas*. If a plan provides that a participant's accumulated benefit is expressed as the sum of benefits determined in terms of two or more benefit formulas, each of which is expressed in terms of a different safe-harbor formula measure, then the plan is deemed to satisfy paragraph (b)(1)(i) of this section with respect to the participant, provided that the plan satisfies the comparison described in paragraph (b)(1)(i) of this section separately for benefits determined in terms of each safe-harbor formula measure and no accumulated benefit of a similarly situated, younger individual who is or could be a participant is expressed other than as—

(*1*) The sum of benefits under two or more benefit formulas, each of which is expressed in terms of one of those same safe-harbor formula measures as is used for the participant's "sum-of" benefit;

(*2*) The greater of benefits under two or more benefit formulas, each of which is expressed in terms of any one of those same safe-harbor formula measures;

(*3*) The choice of benefits under two or more benefit formulas, each of which is expressed in terms of any one of those same safe-harbor formula measures;

(*4*) A benefit that is determined in terms of only one of those same safe-harbor formula measures; or

(*5*) The lesser of benefits under two or more benefit formulas, at least one of which is expressed in terms of one of those same safe-harbor formula measures.

(C) *Greater-of benefit formulas*. If a plan provides that a participant's accumulated benefit is expressed as the greater of benefits under two or more benefit formulas, each of which is determined in terms of a different safe-harbor formula measure, then the plan is deemed to satisfy paragraph (b)(1)(i) of this section with respect to the participant, provided that the plan satisfies the comparison described in paragraph (b)(1)(i) of this section separately for benefits determined in terms of each safe-harbor formula measure and no accumulated benefit of a similarly situated, younger individual who is or could be a participant is expressed other than as—

(*1*) The greater of benefits determined under two or more benefit formulas, each of which is expressed in terms of one of those same safe-harbor formula measures as is used for the participant's "greater-of" benefit;

(*2*) The choice of benefits determined under two or more benefit formulas, each of which is expressed in terms of one of those same safe-harbor formula measures;

(*3*) A benefit that is determined in terms of only one of those same safe-harbor formula measures; or

(*4*) The lesser of benefits under two or more benefit formulas, at least one of which is expressed in terms of one of those same safe-harbor formula measures.

(D) *Choice-of benefit formulas*. If a plan provides that a participant's accumulated benefit is determined pursuant to a choice by the participant between benefits determined in terms of two or more different safe-harbor formula measures, then the plan is deemed to satisfy paragraph (b)(1)(i) of this section with respect to the participant, provided that the plan satisfies the comparison described in paragraph (b)(1)(i) of this section separately for benefits determined in terms of each safe-harbor formula measure and no accumulated benefit of a similarly situated, younger individual who is or could be a participant is expressed other than as—

(*1*) The choice of benefits determined under two or more benefit formulas, each of which is expressed in terms of one of those same safe-harbor formula measures as is used for the participant's "choice-of" benefit;

(*2*) A benefit that is determined in terms of only one of those same safe-harbor formula measures; or

(*3*) The lesser of benefits under two or more benefit formulas, at least one of which is expressed in terms of one of those same safe-harbor formula measures.

(E) *Lesser-of benefit formulas*. If a plan provides that a participant's accumulated benefit is expressed as a single safe-harbor formula measure and no accumulated benefit of a similarly situated, younger individual who is or could be a participant is expressed other than as a benefit that is determined under the same safe-harbor formula measure or as the lesser of benefits under two or more benefit formulas, at least one of which is expressed in terms of the same safe-harbor formula measure, then the plan is deemed to satisfy paragraph (b)(1)(i) of this section with respect to the participant only if the plan satisfies the comparison described in paragraph (b)(1)(i) of this section for benefits determined in terms of the same safe-harbor formula measure. Similarly, if a plan provides that a participant's accumulated benefit is expressed as the lesser of benefits under two or more benefit formulas, each of which is determined in terms of a different safe-harbor formula measure, then the plan is deemed to satisfy paragraph (b)(1)(i) of this section with respect to the participant only if the plan satisfies the comparison described in paragraph (b)(1)(i) of this section separately for benefits determined in terms of each safe-harbor formula measure and no accumulated benefit of a similarly situated, younger individual who is or could be a participant is expressed other than as the lesser of benefits under two or more benefit formulas, expressed in terms of all of those same safe-harbor formula measures (and any other additional formula measures).

(F) *Limitations on plan formulas that provide for hypothetical accounts or accumulated percentages of final average compensation*. For plan years that begin on or after January 1, 2016, a benefit measure is a safe harbor formula measure described in paragraph (b)(1)(i)(B) or (C) of this section only if the formula under which the balance of a hypothetical account or the accumulated percentage of final average compensation is determined is a lump-sum based benefit formula.

(iii) *Disregard of certain subsidized benefits*. For purposes of paragraph (b)(1)(i) of this section, any subsidized portion of an early retirement benefit that is included in a participant's accumulated benefit is disregarded. For this purpose, an early retirement benefit includes a subsidized portion only if it provides a higher actuarial present value on account of commencement before normal retirement age. However, for plan years that begin on or after January 1, 2016, if the annual benefit payable before normal retirement age is greater for a participant than the annual benefit under the corresponding form of benefit for any similarly situated, older individual who is or could be a participant and who is currently at or before normal retirement age, then that excess is not part of the subsidized portion of an early retirement benefit and, accordingly, is not disregarded under this paragraph (b)(1)(iii). For purposes of determining whether the annual benefit payable before normal retirement age is greater for a participant than the annual benefit under the corresponding form of benefit for any similarly situated, older individual who is or could be a participant, social security leveling options and social security supplements are disregarded. In addition, a plan is not treated as providing a greater annual benefit to a participant than to a similarly situated, older individual who is or could be a participant merely because the reduction (based on actuarial equivalence, using reasonable actuarial assumptions) in the amount of an annuity to reflect a survivor benefit is smaller for the participant than for a similarly situated, older individual who is or could be a participant.

* * * * *

(2) *Indexed benefits*—(i) *In general*. Except as provided in paragraph (b)(2)(iii) of this section, pursuant to section 411(b)(5)(E) and this paragraph (b)(2)(i), a defined benefit plan is not treated as failing to meet the requirements of section 411(b)(1)(H) with respect to a participant solely because a benefit formula (other than a lump sum-based benefit formula) under the plan provides for the periodic adjustment of the participant's accrued benefit under the plan by means of the application of a recognized index or methodology. An indexing rate that does not exceed a market rate of return, as defined in paragraph (d) of this section, is deemed to be a recognized index or methodology for purposes of the preceding sentence. In addition, for plan years that begin on or after January 1, 2016 (or an earlier date as elected by the taxpayer), any subsidized portion of any early retirement benefit under such a plan that meets the requirements of paragraph (b)(1)(iii) is disregarded in determining whether the plan meets the requirements of section 411(b)(1)(H). However, such a plan must satisfy the qualification requirements otherwise applicable to statutory hybrid plans, including the requirements of § 1.411(a)(13)–1(c) (relating to minimum vesting standards) and paragraph (c) of this section (relating to plan conversion amendments) if the plan has an effect similar to a lump sum-based benefit formula, pursuant to the rules of § 1.411(a)(13)–1(d)(4)(ii).

* * * * *

(c) * * *

(3) * * * (i) * * * Provided that the requirements of paragraph (c)(3)(ii) of this section are satisfied, a statutory hybrid plan under which an opening hypothetical account balance or opening accumulated percentage of the participant's final average compensation is established as of the effective date of the conversion amendment does not fail to satisfy the requirements of paragraph (c)(2) of this section merely because benefits attributable to that opening hypothetical account balance or opening accumulated percentage (that is, benefits that are not described in paragraph (c)(2)(i)(B) of this section) are substituted for benefits described in paragraph (c)(2)(i)(A) of this section.

* * * * *

(5) * * *

Example 8. (i) *Facts involving establishment of opening hypothetical account balance*. A defined benefit plan provides an accrued benefit expressed as a straight life annuity commencing at the plan's normal retirement age (age 65), based on a percentage of average annual compensation multiplied by the participant's years of service. On January 1, 2009, a conversion amendment is adopted that converts the plan to a statutory hybrid plan. Participant A, age 55, had an accrued benefit under the preconversion formula of $1,500 per month payable at normal retirement age. In conjunction with this conversion, the plan provides each participant with an opening hypothetical account balance equal to the present value, determined in accordance with section 417(e)(3) of the participant's pre-conversion benefit. Participant A's opening hypothetical account balance was calculated as $121,146. The opening account balance (along with any subsequent amounts credited to the hypothetical account) is credited annually with interest credits at the rate of 5.0 percent up to the annuity starting date of each participant.

(ii) *Facts relating to changes between establishment of opening hypothetical account balance and age 65*. Upon attainment of age 65, Participant A elects to receive Participant A's entire benefit under the plan as a single sum distribution. At the annuity starting date, Participant A's hypothetical account balance attributable to Participant A's opening account balance has increased to $197,334. However, under the terms of the plan and in accordance with section 417(e)(3), the present value at the annuity starting date of Participant A's pre-conversion benefit of $1,500 per month is $221,383.

(iii) *Conclusion*. Pursuant to paragraph (c)(3)(ii)(A) of this section, Participant A must receive the benefit attributable to post-conversion service, plus the greater of the benefit attributable to the opening hypothetical account balance and the preconversion benefit (with the determination as to which is greater made at the annuity starting date). Accordingly the single-sum distribution must equal the benefit attributable to post-conversion service plus $221,383.

* * * * *

(d) * * *

(1) * * *

(iv) * * *

(D) *Debits and credits during the interest crediting period*. A plan is not treated as failing to meet the requirements of this paragraph (d) merely because the plan does not provide for interest credits on amounts distributed prior to the end of the interest crediting period. Furthermore, a plan is not treated as failing to meet the requirements of this paragraph (d) merely because the plan calculates increases or decreases to the participant's accumulated benefit by applying a rate of interest or rate of return (including a rate of increase or decrease under an index) to the participant's adjusted accumulated benefit (or portion thereof) for the period. For this purpose, the participant's adjusted accumulated benefit equals the participant's accumulated benefit as of the beginning of the period, adjusted for debits and credits (other than interest credits) made to the accumulated benefit prior to the end of the interest crediting period, with appropriate weighting for those debits and credits based on their timing within the period. For plans that calculate increases or decreases to the participant's accumulated benefit by applying a rate of interest or rate of return to the participant's adjusted accumulated benefit (or portion thereof) for the period, interest credits include these increases and decreases, to the extent provided under the terms of the plan at the beginning of the period and to the extent not conditioned on current service and not made on account of imputed service (as defined in § 1.401(a)(4)–11(d)(3)(ii)(B)), and the interest crediting rate with respect to a participant equals the total amount of interest credits for the period divided by the participant's adjusted accumulated benefit for the period.

* * * * *

(v) * * * Similarly, an interest crediting rate that always equals the lesser of the yield on 30-year Treasury Constant Maturities and a fixed 7 percent interest rate is not in excess of a market rate of return because it can never be in excess of the yield on 30-year Treasury Constant Maturities.

* * * * *

(viii) *Increases to existing rates and addition of other rates*—(A) *Increases to* *existing rates*. The Commissioner may, in guidance published in the Internal Revenue Bulletin, see § 601.601(d)(2)(ii)(*b*) of this chapter, increase an interest crediting rate set forth in this paragraph (d), so that the increased rate is treated as satisfying the requirement that the rate not exceed a market rate of return for purposes of this paragraph (d) and section 411(b)(5)(B). For this purpose, these increases can include increases to the maximum permitted margin that can be added to one or more of the safe harbor rates set forth in paragraph (d)(4) of this section, increases to the maximum permitted fixed rate set forth in paragraph (d)(4)(v) of this section, or increases to a maximum permitted annual floor set forth in paragraph (d)(6) of this section.

(B) *Additional rates*. The Commissioner may, in guidance published in the Internal Revenue Bulletin, see § 601.601(d)(2)(ii)(*b*) of this chapter, provide for additional interest crediting rates that satisfy the requirement that they not exceed a market rate of return for purposes of this paragraph (d) and section 411(b)(5)(B) (including providing for additional combinations of rates, such as annual minimums in conjunction with rates that are based on rates described in paragraph (d)(5) of this section but that are reduced in order to ensure that the effective rate of return does not exceed a market rate of return).

* * * * *

(2) *Preservation of capital requirement*—(i) *General rule*. A statutory hybrid plan satisfies the requirements of section 411(b)(1)(H) only if the plan provides that the participant's benefit under the statutory hybrid benefit formula determined as of the participant's annuity starting date is no less than the benefit determined as if the accumulated benefit were equal to the sum of all principal credits (as described in paragraph (d)(1)(ii)(D) of this section) credited under the plan to the participant as of that date (including principal credits that were credited before the applicable statutory effective date of paragraph (f)(1) of this section). This paragraph (d)(2) applies only as of an annuity starting date, within the meaning of § 1.401(a)–20, A–10(b), with respect to which a distribution of the participant's entire vested benefit under the plan's statutory hybrid benefit formula as of that date commences. For a participant who has more than one annuity starting date, paragraph (d)(2)(ii) of this section provides rules to account for prior annuity starting dates when applying this paragraph (d)(2)(i).

(ii) *Application to multiple annuity starting dates*—(A) *In general*. If the comparison under paragraph (d)(2)(ii)(B) of this section results in the sum of all principal credits credited to the participant (as of the current annuity starting date) exceeding the sum of the amounts described in paragraphs (d)(2)(ii)(B)(*1*) through (d)(2)(ii)(B)(*3*) of this section, then the participant's benefit to be distributed at the current annuity starting date must be no less than would be provided if that excess were included in the current accumulated benefit.

(B) *Comparison to reflect prior distributions*. For a participant who has more than one annuity starting date, the sum of all principal credits credited to the participant under the plan, as of the current annuity starting date, is compared to the sum of—

(*1*) The remaining balance of the participant's accumulated benefit as of the current annuity starting date;

(*2*) The amount of the reduction to the participant's accumulated benefit under the statutory hybrid benefit formula that is attributable to any prior distribution of the participant's benefit under that formula; and

(*3*) Any amount that was treated as included in the accumulated benefit under the rules of this paragraph (d)(2) as of any prior annuity starting date.

(C) *Special rule for participants with 5 or more breaks in service*. A plan is permitted to provide that, in the case of a participant who receives a distribution of the entire vested benefit under the plan and thereafter completes 5 consecutive 1-year breaks in service, as defined in section 411(a)(6)(A), the rules of this paragraph (d)(2) are applied without regard to the prior period of service. Thus, in the case of such a participant, the plan is permitted to provide that the rules of this paragraph (d)(2) are applied disregarding the principal credits and distributions that occurred before the breaks in service.

* * * * *

(3) *Long-term investment grade corporate bonds*. For purposes of this paragraph (d), the rate of interest on long-term investment grade corporate bonds means the third segment rate described in section 417(e)(3)(D) or 430(h)(2)(C)(iii) (determined with or without regard to section 430(h)(2)(C)(iv) and with or without regard to the transition rules of section 417(e)(3)(D)(ii) or 430(h)(2)(G)). However, for plan years beginning prior to January 1, 2008, the rate of interest on long-term investment grade corporate bonds means the rate described in section 412(b)(5)(B)(ii)(II) prior to amendment by the Pension Protection Act of 2006, Public Law 109–280 (120 Stat. 780 (2006)) (PPA '06).

(4) * * *

(ii) *Rates based on government bonds with margins*. An interest crediting rate is deemed to be not in excess of the interest rate described in paragraph (d)(3) of this section if the rate is equal to the sum of any of the following rates of interest for bonds and the associated margin for that interest rate:

Interest Rate Bond Index	Associated Margin
The discount rate on 3-month Treasury Bills	175 basis points
The discount rate on 12-month or shorter Treasury Bills	150 basis points
The yield on 1-year Treasury Constant Maturities	100 basis points
The yield on 3-year or shorter Treasury Constant Maturities	50 basis points
The yield on 7-year or shorter Treasury Constant Maturities	25 basis points
The yield on 30-year or shorter Treasury Constant Maturities	0 basis points

* * * * *

(iv) *Short and mid-term investment grade corporate bonds*. An interest crediting rate equal to the first segment rate is deemed to be not in excess of the interest rate described in paragraph (d)(3) of this section. Similarly, an interest crediting rate equal to the second segment rate is deemed to be not in excess of the interest rate described in paragraph (d)(3) of this section. For this purpose, the first and second segment rates mean the first and second segment rates described in section 417(e)(3)(D) or 430(h)(2)(C), determined with or without regard to section 430(h)(2)(C)(iv) and with or without regard to the transition rules of section 417(e)(3)(D)(ii) or 430(h)(2)(G).

(v) *Fixed rate of interest*. An annual interest crediting rate equal to a fixed 6 percent is deemed to be not in excess of the interest rate described in paragraph (d)(3) of this section.

(5) * * *

(ii) *Actual rate of return on plan assets*—(A) *In general*. An interest crediting rate equal to the actual rate of return on the aggregate assets of the plan, including both positive returns and negative returns, is not in excess of a market rate of return if the plan's assets are diversified so as to minimize the volatility of returns. This requirement that plan assets be diversified so as to minimize the volatility of returns does not require greater diversification than is required under section 404(a)(1)(C) of Title I of the Employee Retirement Income Security Act of 1974, Public Law 93–406 (88 Stat. 829 (1974)), as amended (ERISA), with respect to defined benefit pension plans.

(B) *Subset of plan assets*. An interest crediting rate equal to the actual rate of return on the assets within a specified subset of plan assets, including both positive and negative returns, is not in excess of a market rate of return if—

(*1*) The subset of plan assets is diversified so as to minimize the volatility of returns, within the meaning of paragraph (d)(5)(ii)(A) of this section (thus, this requirement is satisfied if the subset of plan assets is diversified such that it would meet the requirements of paragraph (d)(5)(ii)(A) of this section if the subset were aggregate plan assets);

(*2*) The aggregate fair market value of qualifying employer securities and qualifying employer real property (within the meaning of section 407 of ERISA) held in the subset of plan assets does not exceed 10 percent of the fair market value of the aggregate assets in the subset; and

(*3*) The fair market value of the assets within the subset of plan assets approximates the liabilities for benefits that are adjusted by reference to the rate of return on the assets within the subset, determined using reasonable actuarial assumptions.

(C) *Examples*. The following examples illustrate the application of paragraph (d)(5)(ii)(B) of this section:

Example 1. (i) *Facts*. (a) Employer A sponsors a defined benefit plan under which benefit accruals are determined under a formula that is not a statutory hybrid benefit formula. Effective January 1, 2015, the plan is amended to cease future accruals under the existing formula and to provide future benefit accruals under a statutory hybrid benefit formula that uses hypothetical accounts. For service on or after January 1, 2015, the terms of the plan provide that each participant's hypothetical account balance is credited monthly with a pay credit equal to a specified percentage of the participant's compensation during the month. The plan also provides that hypothetical account balance is increased or decreased by an interest credit, which is calculated as the product of the account balance at the beginning of the period and the net rate of return on the assets within a specified subset of plan assets during that period. Under the terms of the plan, the net rate of return is equal to the actual rate of return adjusted to reflect a reduction for specified plan expenses. The plan does not provide for interest credits on amounts that are distributed prior to the end of an interest crediting period.

(b) As of the effective date of the amendment, there are no assets in the specified subset of plan assets. Under the terms of the plan, an amount is added to the specified subset at the time each subsequent contribution for any plan year starting on or after the effective date of the amendment is made to the plan. The amount added (the formula contribution) is the amount deemed necessary to fund benefit accruals under the statutory hybrid benefit formula. Investment of the specified subset is diversified so as to minimize the volatility of returns, within the meaning of paragraph (d)(5)(ii)(A) of this section, and no qualifying employer securities or qualifying employer real property (within the meaning of section 407 of ERISA) are held in the subset. Benefits accrued under the statutory hybrid benefit formula are paid from the specified subset. However, if assets of the specified subset are insufficient to pay benefits accrued under the statutory hybrid benefit formula, the plan provides that assets of the residual legacy subset of plan assets (from which benefits accrued before January 1, 2015 are paid) are available to pay those benefits in accordance with the requirement that all assets of the plan be available to pay all plan benefits. Except as described in this paragraph, no other amounts are added to or subtracted from the specified subset of plan assets.

(c) The formula contribution for each plan year that is added to the specified subset of plan assets is an amount equal to the sum of the target normal cost of the statutory hybrid benefit formula for the plan year plus an additional amount intended to reflect gains or losses. This additional amount is equal to the annual amount necessary to amortize the difference between the funding target attributable to the statutory hybrid benefit formula portion of the plan for the plan year over the value of plan assets included in the specified subset of plan assets for the plan year in level annual installments over a 7-year period. For this purpose, target normal cost and funding target are determined under the rules of § 1.430(d)–1 as if the statutory hybrid benefit formula portion of the plan were the entire plan and without regard to special rules that are applicable to a plan in at-risk status, even if the plan is in at-risk status for a plan year. If the formula contribution for a plan year exceeds the amount of the actual contribution to the plan for a year (such as could be the case if all or a portion of the contribution is offset by all or a portion of the plan's prefunding balance), then an amount equal to the excess of the formula contribution over the actual contribution is transferred from the residual legacy subset of plan assets to the specified subset of plan assets on the plan's due date for the minimum required contribution for the year.

(ii) *Conclusion*. The specified subset is diversified so as to minimize the volatility of returns (within the meaning of paragraph (d)(5)(ii)(A) of this section). The aggregate fair market value of qualifying employer securities and qualifying employer real property (within the meaning of section 407 of ERISA) held in the specified subset do not exceed 10 percent of the fair market value of the aggregate assets in the subset. The fair market value of the assets within the specified subset of plan assets approximates the liabilities for benefits that are adjusted by reference to the rate of return on the assets within the subset, determined using reasonable actuarial assumptions, within the meaning of paragraph (d)(5)(ii)(B)(*3*) of this section. Therefore, the interest crediting rate under the statutory hybrid benefit formula portion of Employer A's defined benefit plan is not in excess of a market rate of return.

Example 2. (i) *Facts*. (a) Pursuant to a collective bargaining agreement, Employer X, Employer Y and Employer Z maintain and contribute to a multiemployer plan (as defined in section 414(f)) that is established as of January 1, 2015 under which benefit accruals are determined under a variable annuity benefit formula. The plan provides that, on an annual basis, the benefit of each participant who has not yet retired is adjusted by reference to the difference between the actual return on the assets within a specified subset of plan assets and 4 percent. A participant's benefits are fixed at retirement and thereafter are not adjusted.

(b) As of the effective date of the plan, there are no assets in the specified subset. Under the terms of the plan, any amount contributed to the plan by a contributing employer is added to the specified subset at the time of the contribution. Investment of the specified subset is diversified so as to minimize the volatility of returns, within the meaning of paragraph (d)(5)(ii)(A) of this section, and no qualifying employer securities or qualifying employer real property (within the meaning of section 407 of ERISA) are held in the subset. The plan provides that, at the time of a participant's retirement, an amount equal to the present value of the liability for benefits payable to that participant is transferred to a separate subset of plan assets (the retiree pool). The retiree pool is invested in high-quality bonds in an attempt to achieve cash-flow matching of the retiree liabilities. Benefits are paid from the retiree pool. However, if assets of the retiree pool are insufficient to pay benefits, the plan provides that assets of the specified subset are available to pay benefits in accordance with the requirement that all assets of the plan be available to pay all plan benefits. Except as described in this paragraph, no other amounts are added to or subtracted from the specified subset of plan assets.

(ii) *Conclusion*. The specified subset is diversified so as to minimize the volatility of returns (within the meaning of paragraph (d)(5)(ii)(A) of this section). The aggregate fair market value of qualifying employer securities and qualifying employer real property (within the meaning of section 407 of ERISA) held in the specified subset do not exceed 10 percent of the fair market value of the aggregate assets in the subset. The fair market value of the assets within the specified subset of plan assets approximates the liabilities for benefits that are adjusted by reference to the rate of return on the assets within the subset, determined using reasonable actuarial assumptions, within the meaning of paragraph (d)(5)(ii)(B)(*3*) of this section. Therefore, the methodology used to adjust participant benefits under the plan's variable annuity benefit formula, which is a statutory hybrid benefit formula under § 1.411(a)(13)–1(d)(4), is not in excess of a market rate of return.

* * * * *

(iv) *Rate of return on certain RICs*. An interest crediting rate is not in excess of a market rate of return if it is equal to the rate of return on a regulated investment company (RIC), as defined in section 851, that is reasonably expected to be not significantly more volatile than the broad United States equities market or a similarly broad international equities market. For example, a RIC that has most of its assets invested in securities of issuers (including other RICs) concentrated in an industry sector or a country other than the United States generally would not meet this requirement. Likewise a RIC that uses leverage, or that has significant investment in derivative financial products, for the purpose of achieving returns that amplify the returns of an unleveraged investment, generally would not meet this requirement. Thus, a RIC that has most of its investments concentrated in the semiconductor industry or that uses leverage in order to provide a rate of return that is twice the rate of return on the Standard & Poor's 500 index (S&P 500) would not meet this requirement. On the other hand, a RIC with investments that track the rate of return on the S&P 500, a broad-based "small-cap" index (such as the Russell 2000 index), or a broad-based international equities index would meet this requirement.

(6) * * *

(ii) *Annual or more frequent floor*—(A) *Application to segment rates*. An interest crediting rate under a plan does not fail to be described in paragraph (d)(3) or (d)(4)(iv) of this section for an interest crediting period merely because the plan provides that the interest crediting rate for that interest crediting period equals the greater of—

(*1*) An interest crediting rate described in paragraph (d)(3) or (d)(4)(iv) of this section; and

(*2*) An annual interest rate of 4 percent or less (or a pro rata portion of an annual interest rate of 4 percent or less for plans that provide interest credits more frequently than annually).

(B) *Application to other bond-based rates*. An interest crediting rate under a plan does not fail to be described in paragraph (d)(4) of this section for an interest crediting period merely because the plan provides that the interest crediting rate for that interest crediting period equals the greater of—

(*1*) An interest crediting rate described in paragraph (d)(4)(ii) or (d)(4)(iii) of this section; and

(*2*) An annual interest rate of 5 percent or less (or a pro rata portion of an annual interest rate of 5 percent or less for plans that provide interest credits more frequently than annually).

(iii) *Cumulative floor applied to investment-based or bond-based rates*—(A) *In general*. A plan that determines interest credits under a statutory hybrid benefit formula using a particular interest crediting rate described in paragraph (d)(3), (d)(4), or (d)(5) of this section (or an interest crediting rate that can never be in excess of a particular interest crediting rate described in paragraph (d)(3), (d)(4) or (d)(5) of this section) does not provide an effective interest crediting rate in excess of a market rate of return merely because the plan provides that the participant's benefit under the statutory hybrid benefit formula determined as of the participant's annuity starting date is equal to the benefit determined as if the accumulated benefit were equal to the greater of—

(*1*) The accumulated benefit determined using the interest crediting rate; and

(*2*) The accumulated benefit determined as if the plan had used a fixed annual interest crediting rate equal to 3 percent (or a lower rate) for all principal credits that are credited under the plan to the participant during the guarantee period (minimum guarantee amount).

(B) *Guarantee period defined*. The guarantee period is the prospective period that begins on the date the cumulative floor described in this paragraph (d)(6)(iii) begins to apply to the participant's benefit and that ends on the date on which that cumulative floor ceases to apply to the participant's benefit.

(C) *Application to multiple annuity starting dates*. The determination under this paragraph (d)(6)(iii) is made only as of an annuity starting date, within the meaning of § 1.401(a)–20, A–10(b), with respect to which a distribution of the participant's entire vested benefit under the plan's statutory hybrid benefit formula as of that date commences. For a participant who has more than one annuity starting date, paragraph (d)(6)(iii)(D) of this section provides rules to account for prior annuity starting dates when applying paragraph (d)(6)(iii)(A) of this section. If the comparison under paragraph (d)(6)(iii)(D) of this section results in the minimum guarantee amount exceeding the sum of the amounts described in paragraphs (d)(6)(iii)(D)(*1*) through (d)(6)(iii)(D)(*3*) of this section, then the participant's benefit to be distributed at the current annuity starting date must be no less than would be provided if that excess were included in the current accumulated benefit.

(D) *Comparison to reflect prior distributions*. For a participant who has more than one annuity starting date, the minimum guarantee amount (described in paragraph (d)(6)(iii)(A)(*2*) of this section), as of the current annuity starting date, is compared to the sum of—

(*1*) The remaining balance of the participant's accumulated benefit, as of the current annuity starting date, to which a minimum guaranteed rate described in paragraph (d)(6)(iii)(A)(*2*) of this section applies;

(*2*) The amount of the reduction to the participant's accumulated benefit under the statutory hybrid benefit formula that is attributable to any prior distribution of the participant's benefit under that formula and to which a minimum guaranteed rate described in paragraph (d)(6)(iii)(A)(*2*) of this section applied, together with interest at that minimum guaranteed rate annually from the prior annuity starting date to the current annuity starting date; and

(*3*) Any amount that was treated as included in the accumulated benefit under the rules of this paragraph (d)(6)(iii) as of any prior annuity starting date, together with interest annually at the minimum guaranteed rate that applied to the prior distribution from the prior annuity starting date to the current annuity starting date.

(E) *Application to portion of participant's benefit*. A cumulative floor described in this paragraph (d)(6)(iii) may be applied to a portion of a participant's benefit, provided the requirements of this paragraph (d)(6)(iii) are satisfied with respect to that portion of the benefit. If a cumulative floor described in this paragraph (d)(6)(iii) applies to a portion of a participant's benefit, only the principal credits that are attributable to that portion of the participant's benefit are taken into account in determining the amount of the guarantee described in paragraph (d)(6)(iii)(A)(*2*) of this section.

(e) * * *

(2) *Plan termination*—(i) *In general*. This paragraph (e)(2) provides special rules that apply for purposes of determining certain plan factors under a statutory hybrid benefit formula after the plan termination date of a statutory hybrid plan. The terms of a statutory hybrid plan must reflect the requirements of this paragraph (e)(2). Paragraph (e)(2)(ii) of this section sets forth rules relating to the interest crediting rate for interest crediting periods that end after the plan termination date. Paragraph (e)(2)(iii) of this section sets forth rules for converting a participant's accumulated benefit to an annuity after the plan termination date. Paragraph (e)(2)(iv) of this section sets forth rules of application. Paragraph (e)(2)(v) of this section contains examples. The Commissioner may, in revenue rulings, notices, or other guidance published in the Internal Revenue Bulletin, provide for additional rules that apply for purposes of this paragraph (e)(2) and the plan termination provisions of section 411(b)(5)(B)(vi). See § 601.601(d)(2)(ii)(*b*) of this chapter. See also regulations of the Pension Benefit Guaranty Corporation for additional rules that apply when a pension plan subject to Title IV of ERISA is terminated.

(ii) *Interest crediting rates used to determine accumulated benefits*—(A) *General rule*. The interest crediting rate used under the plan to determine a participant's accumulated benefit for interest crediting periods that end after the plan termination date must be equal to the average of the interest rates used under the plan during the 5-year period ending on the plan termination date. Except as otherwise provided in this paragraph (e)(2)(ii), the actual annual interest rate (taking into account minimums, maximums, and other adjustments) used to determine interest credits under the plan for each of the interest crediting periods is used for purposes of determining the average of the interest rates.

(B) *Special rule for variable interest crediting rates that are other rates of return*—(*1*) *Application to interest crediting periods*. This paragraph (e)(2)(ii)(B) applies for an interest crediting period if the interest crediting rate that was used for that interest crediting period was a rate of return described in paragraph (d)(5) of this section. This paragraph (e)(2)(ii)(B) also applies for an interest crediting period that begins before the first plan year that begins on or after January 1, 2016, if the interest crediting rate that was used for that interest crediting period had the potential to be negative. For this purpose, a rate is not treated as having the potential to be negative if it is a rate described in paragraph (d)(3) or (d)(4) of this section or is any other rate that is based solely on current bond yields.

(*2*) *Use of substitution rate*. For any interest crediting period to which this paragraph (e)(2)(ii)(B) applies, for purposes of determining the average of the interest rates under this paragraph (e)(2)(ii), the interest rate used under the plan for the interest crediting period is deemed to be equal to the substitution rate (as described in paragraph (e)(2)(ii)(C) of this section) for the period.

(C) *Definition of substitution rate*. The substitution rate for any interest crediting period equals the second segment rate under section 430(h)(2)(C)(ii) (determined without regard to section 430(h)(2)(C)(iv)) for the last calendar month ending before the beginning of the interest crediting period, as adjusted to account for any minimums or maximums that applied in the period (other than cumulative floors under paragraph (d)(6)(iii) of this section), but without regard to other reductions that applied in the period. Thus, for example, if the actual interest crediting rate in an interest crediting period is equal to the rate of return on plan assets, but not greater than 5 percent, then the substitution rate for that interest crediting period is equal to the lesser of the applicable second segment rate for the period and 5 percent. However, if the actual interest crediting rate for an interest crediting period is equal to the rate of return on plan assets minus 200 basis points, then the substitution rate for that interest crediting period is equal to the applicable second segment rate for the period.

(D) *Cumulative floors*. Cumulative floors under paragraph (d)(6)(iii) of this section that applied during the 5-year period ending on the plan termination date are not taken into account for purposes of determining the average of the interest rates under this paragraph (e)(2)(ii). However, the rules of paragraph (d)(6)(iii) of this section continue to apply to determine benefits as of annuity starting dates on or after the plan termination date. Thus, if, as of an annuity starting date on or after the plan termination date, the benefit provided by applying an applicable cumulative minimum rate under paragraph (d)(6)(iii)(A)(*2*) of this section exceeds the benefit determined by applying interest credits to the participant's accumulated benefit (with interest credits for interest crediting periods that end after the plan termination date determined under this paragraph (e)(2)), then that cumulative minimum rate is used to determine benefits as of that annuity starting date.

(iii) *Annuity conversion rates and factors*—(A) *Conversion factors where a separate mortality table was used prior to* *plan termination*—(*1*) *Use of a separate mortality table*. This paragraph (e)(2)(iii)(A) applies for purposes of converting a participant's accumulated benefit to an annuity after the plan termination date if, for the entire 5-year period ending on the plan termination date, the plan provides for a mortality table in conjunction with an interest rate to be used to convert a participant's accumulated benefit (or a portion thereof) to an annuity. If this paragraph (e)(2)(iii)(A) applies, then the plan is treated as meeting the requirements of section 411(b)(5)(B)(i) and paragraph (d)(1) of this section only if, for purposes of converting a participant's accumulated benefit (or portion thereof) to an annuity for annuity starting dates after the plan termination date, the mortality table used is the table described in paragraph (e)(2)(iii)(A)(*2*) of this section and the interest rate is the rate described in paragraph (e)(2)(iii)(A)(*3*) of this section.

(*2*) *Specific mortality table*. The mortality table used is the mortality table specified under the plan for purposes of converting a participant's accumulated benefit to an annuity as of the termination date. This mortality table is used regardless of whether it was used during the entire 5-year period ending on the plan termination date. For purposes of applying this paragraph (e)(2)(iii)(A)(*2*), if the mortality table specified in the plan, as of the plan termination date, is a mortality table that is updated to reflect expected improvements in mortality experience (such as occurs with the applicable mortality table under section 417(e)(3)), then the table used for an annuity starting date after the plan termination date takes into account updates through the annuity starting date.

(*3*) *Specific interest rate*. The interest rate used is the interest rate specified under the plan for purposes of converting a participant's accumulated benefit to an annuity for annuity starting dates after the plan termination date. However, if the interest rate used under the plan for purposes of converting a participant's accumulated benefit to an annuity has not been the same fixed rate during the 5-year period ending on the plan termination date, then the interest rate used for purposes of converting a participant's accumulated benefit to an annuity for annuity starting dates after the plan termination date is the average interest rate that applied for this purpose during the 5-year period ending on the plan termination date.

(B) *Tabular factors*. If, as of the plan termination date, a tabular annuity conversion factor (i.e., a single conversion factor that combines the effect of interest and mortality) is used to convert a participant's accumulated benefit (or a portion thereof) to an annuity and that same fixed tabular annuity conversion factor has been used during the entire 5-year period ending on the plan termination date, then the plan satisfies the requirements of this paragraph (e)(2)(iii) only if that same tabular annuity conversion factor continues to apply after the plan termination date. However, if the tabular annuity conversion factor used to convert a participant's accumulated benefit (or a portion thereof) to an annuity is not described in the preceding sentence (including any case in which the tabular annuity conversion factor was a fixed conversion factor that changed during the 5-year period ending on the plan termination date), then the plan satisfies the requirements of this paragraph (e)(2)(iii) only if the tabular annuity conversion factor used to convert a participant's accumulated benefit (or a portion thereof) to an annuity for annuity starting dates after the plan termination date is equal to the average of the tabular annuity conversion factors used under the plan for that purpose during the 5-year period ending on the plan termination date.

(C) *Factor applicable where a separate mortality table was not used for entire 5-year period prior to plan termination*. If paragraph (e)(2)(iii)(A) of this section does not apply (including any case in which a separate mortality table was used in conjunction with a separate interest rate to convert a participant's accumulated benefit (or a portion thereof) to an annuity for only a portion of the 5-year period ending on the plan termination date), then the plan is treated as having used a tabular annuity conversion factor to convert a participant's accumulated benefit (or a portion thereof) to an annuity for the entire 5-year period ending on the plan termination date. As a result, the rules of paragraph (e)(2)(iii)(B) of this section apply to determine the annuity conversion factor used for purposes of converting a participant's accumulated benefit (or portion thereof) to an annuity for annuity starting dates after the plan termination date. For this purpose, if a separate mortality table and separate interest rate applied for a portion of the 5-year period, that mortality table and interest rate are used to calculate an annuity conversion factor and that factor is treated as having been the tabular annuity conversion factor that applied for that portion of the 5-year period for purposes of this paragraph (e)(2)(iii).

(D) *Separate application with respect to optional forms*. This paragraph (e)(2)(iii) applies separately with respect to each optional form of benefit on the date of plan termination. For this purpose, the term optional form of benefit has the meaning given that term in § 1.411(d)–3(g)(6)(ii), except that a change in the annuity conversion factor used to determine a particular benefit is disregarded in determining whether different optional forms exist. Thus, for example, if, for the entire 5-year period ending on the plan termination date, the plan provides for a mortality table in conjunction with an interest rate to be used to determine annuities other than qualified joint and survivor annuities, but for specified tabular factors to apply to determine annuities that are qualified joint and survivor annuities, then paragraph (e)(2)(iii)(A) of this section applies for purposes of annuities other than qualified joint and survivor annuities and paragraph (e)(2)(iii)(B) of this section applies for purposes of annuities that are qualified joint and survivor annuities. In addition, if the annuity conversion factor used to determine a particular qualified joint and survivor annuity has changed in the 5-year period ending on the plan termination date, the different factors are averaged for purposes of determining the annuity conversion factor that applies after plan termination for that particular qualified joint and survivor annuity.

(iv) *Rules of application*—(A) *Average of interest rates for crediting interest*—(*1*) *In general*. For purposes of determining the average of the interest rates under paragraph (e)(2)(ii) of this section, an interest crediting period is taken into account if the interest crediting date for the interest crediting period is within the

5-year period ending on the plan termination date. The average of the interest rates is determined as the arithmetic average of the annual interest rates used for those interest crediting periods. If the interest crediting periods taken into account are not all the same length, then each rate is weighted to reflect the length of the interest crediting period in which it applied. If the plan provides for the crediting of interest more frequently than annually, then interest credits after the plan termination date must be prorated in accordance with the rules of paragraph (d)(1)(iv)(C) of this section.

(*2*) *Section 411(d)(6) protected accumulated benefit*. In general, the interest rate that was used for each interest crediting period is the ongoing interest crediting rate that was specified under the plan for that period, without regard to any interest rate that was used prior to an amendment changing the interest crediting rate with respect to a section 411(d)(6) protected benefit. However, if, as of the end of the last interest crediting period that ends on or before the plan termination date, the participant's accumulated benefit is based on a section 411(d)(6) protected benefit that results from a prior amendment to change the rate of interest crediting applicable under the plan, then the pre-amendment interest rate is treated as having been used for each interest crediting period after the date of the interest crediting rate change (so that the amendment is disregarded).

(B) *Average annuity conversion rates and factors*—(*1*) *In general*. For purposes of determining average annuity conversion interest rates and average tabular annuity conversion factors under paragraph (e)(2)(iii) of this section, an interest rate or tabular annuity conversion factor is taken into account if the rate or conversion factor applied under the terms of the plan to convert a participant's accumulated benefit (or a portion thereof) to a benefit payable in the form of an annuity during the 5-year period ending on the plan termination date. The average is determined as the arithmetic average of the interest rates or tabular factors used during that period. If the periods in which the rates or factors that are averaged are not all the same length, then each rate or factor is weighted to reflect the length of the period in which it applied.

(*2*) *Section 411(d)(6) protected annuity conversion factors*. In general, the annuity conversion interest rate or tabular annuity conversion factor that was used for each period is the ongoing interest rate or tabular factor that was specified under the plan for that period, without regard to any rate or factor that was used under the plan prior to an amendment changing the rate or factor with respect to a section 411(d)(6) protected benefit. However, if, as of the plan termination date, the participant's annuity benefit for an annuity commencing at that date would be based on a section 411(d)(6) protected benefit that results from a prior amendment to change the rate or factor under the plan, then the pre-amendment rate or factor is treated as having been used after the date of the amendment (so that the amendment is disregarded).

(C) *Blended rates*. If, as of the plan termination date, the plan determines interest credits by applying different rates to two or more different predetermined portions of the accumulated benefit, then the interest crediting rate that applies after the plan termination date is determined separately with respect to each portion under the rules of paragraph (e)(2)(ii) of this section.

(D) *Participants with less than 5 years of interest credits upon plan termination*. If the plan provided for interest credits for any interest crediting period in which, pursuant to the terms of the plan, an individual was not eligible to receive interest credits (including because the individual was not a participant or beneficiary in the relevant interest crediting period), then, for purposes of determining the individual's average interest crediting rate under paragraph (e)(2)(ii) of this section, the individual is treated as though the individual received interest credits in that period using the interest crediting rate that applied in that period under the terms of the plan to a similarly situated participant or beneficiary who was eligible to receive interest credits.

(E) *Plan termination date*—(*1*) *Plans subject to Title IV of ERISA*. In the case of a plan that is subject to Title IV of ERISA, the plan termination date for purposes of this paragraph (e)(2) means the plan's termination date established under section 4048(a) of ERISA.

(*2*) *Other plans*. In the case of a plan that is not subject to Title IV of ERISA, the plan termination date for purposes of this paragraph (e)(2) means the plan's termination date established by the plan administrator, provided that the plan termination date may be no earlier than the date on which the actions necessary to effect the plan termination - other than the distribution of plan benefits - are taken. However, a plan is not treated as terminated on the plan's termination date if the assets are not distributed as soon as administratively feasible after that date. See Rev. Rul. 89–87 (1989–2 CB 2), (see § 601.601(d)(2)(ii)(*b*) of this chapter).

(v) *Examples*. The following examples illustrate the rules of this paragraph (e)(2). In each case, it is assumed that the plan is terminated in a standard termination.

Example 1. (i) *Facts*. (A) Plan A is a defined benefit plan with a calendar plan year that expresses each participant's accumulated benefit in the form of a hypothetical account balance to which principal credits are made at the end of each calendar quarter and to which interest is credited at the end of each calendar quarter based on the balance at the beginning of the quarter. Interest credits under Plan A are based on a rate of interest fixed at the beginning of each plan year equal to the third segment rate for the preceding December, except that the plan used the rate of interest on 30-year Treasury bonds (instead of the third segment rate) for plan years before 2013. The plan is terminated on March 3, 2017.

(B) The third segment rate credited under Plan A from January 1, 2013, through December 31, 2016, is assumed to be: 6 percent annually for each of the four quarters in 2016; 6.5 percent annually for each of the four quarters in 2015; 6 percent annually for each of the four quarters in 2014; and 5.5 percent annually for each of the four quarters in 2013. The rate of interest on 30-year Treasury bonds credited under Plan A for each of the four quarters in 2012 is assumed to be 4.4 percent annually.

(ii) *Conclusion*. Pursuant to paragraph (e)(2)(ii) of this section, the interest crediting rate used to determine accrued benefits under the plan on and after the date of plan termination is an annual rate of 5.68 percent (which is the arithmetic average of 6 percent, 6.5 percent, 6 percent, 5.5 percent, and 4.4 percent). In accordance with the rules of paragraph (d)(1)(iv)(C) of this section, the quarterly interest crediting rate after the plan termination date is 1.42 percent (5.68 divided by 4).

Example 2. (i) *Facts*. The facts are the same as *Example 1*. Participant S, who terminated employment before January 1, 2017, has a hypothetical account balance of $100,000 when the plan is terminated on March 3, 2017. Participant S commences distribution in the form of a straight life annuity commencing on January 1, 2020. For the entire 5-year period ending on the plan termination date, the plan has provided that the applicable section 417(e) rates for the preceding August are applied on the annuity starting date in order to convert the hypothetical account balance to an annuity. Based on the 5-year averages of the first segment rates, the second segment rates, and the third segment rates as of the plan termination date, and the applicable mortality table for the year 2020, the resulting conversion rate at the January 1, 2020 annuity starting date is 166.67 for a monthly straight life annuity payable to a participant whose age is the age of Participant S on January 1, 2020.

(ii) *Conclusion*. In accordance with the conclusion in *Example 1*, the interest crediting rate after the plan termination date is 1.42 percent for each of the 12 quarterly interest crediting dates in the period from March 3, 2017, through December 31, 2019, so that Participant S's account balance is $118,436 on December 31, 2019. As a result, using the annuity conversion rate of 166.67, the amount payable to Participant S commencing on January 1, 2020 is $711 per month.

Example 3. (i) *Facts*. The facts are the same as *Example 1*. In addition, Participant T commenced participation in Plan A on April 17, 2014.

(ii) *Conclusion*. In accordance with the conclusion in *Example 1* and the rule of paragraph (e)(2)(iv)(D) of this section, the quarterly interest crediting rate used to determine Participant T's accrued benefits under Plan A on and after the date of plan termination is 1.42 percent, which is the same rate that applies to all participants and beneficiaries in Plan A after the termination date (and that would have applied to Participant T if Participant T had participated in the plan during the 5-year period preceding the date of plan termination).

Example 4. (i) *Facts*. (A) Plan B is a defined benefit plan with a calendar plan year that expresses each participant's accumulated benefit in the form of a hypothetical account balance to which principal credits are made at the end of each calendar year and to which interest is credited at the end of each calendar year based on the balance at the end of the preceding year. The plan is terminated on January 27, 2018.

(B) The plan's interest crediting rate for each calendar year during the entire 5-year period ending on the plan termination date is equal to (A) 50 percent of the greater of the rate of interest on 3-month Treasury Bills for the preceding December and an annual rate of 4 percent, plus (B) 50 percent of the rate of return on plan assets. The rate of interest on 3-month Treasury Bills credited under Plan B is assumed to be: 3.4 percent for 2017; 4 percent for 2016; 4.5 percent for 2015; 3.5 percent for 2014; and 4.2 percent for 2013. Each of these rates applied under Plan B for purposes of determining the interest credits described in clause (A) of this paragraph (i), except that the 4 percent minimum rate applied for 2017 and 2014. The second segment rate is assumed to be: 6 percent for December 2016; 6 percent for December 2015; 6.5 percent for December 2014; 6 percent for December 2013; and 5.5 percent for December 2012.

(ii) *Conclusion*. Pursuant to paragraph (e)(2)(ii) of this section, the interest crediting rate used to determine accrued benefits under the plan on and after the date of plan termination is 5.07 percent. This number is equal to the sum of 50 percent of 4.14 percent (which is the sum of 4 percent, 4 percent, 4.5 percent, 4 percent, and 4.2 percent, divided by 5), and 50 percent of 6 percent (which is the average second segment rate applicable for the 5 interest crediting periods ending within the 5-year period, as applied pursuant to the substitution rule described in paragraphs (e)(2)(ii)(B) and (C) of this section).

Example 5. (i) *Facts*. The facts are the same as in *Example 4*, except that the plan had credited interest before January 1, 2016, using the rate of return on a specified RIC and had been amended effective January 1, 2016, to base interest credits for all plan years after 2015 on the interest rate formula described in paragraph (i) of *Example 4*. In order to comply with section 411(d)(6), the plan provides that, for each participant or beneficiary who was a participant on December 31, 2015, benefits at any date are based on either the ongoing hypothetical account balance on that date (which is based on the December 31, 2015 balance, with interest credited thereafter at the rate described in the first sentence of paragraph (i) of *Example 4* and taking principal credits after 2015 into account) or a special hypothetical account balance (the pre-2016 balance) on that date, whichever balance is greater. For each participant, the pre-2016 balance is a hypothetical account balance equal to the participant's December 31, 2015 balance, with interest credited thereafter at the RIC rate of return, but with no principal credits after 2015. There are 10 participants for whom the pre-2016 balance exceeds the ongoing hypothetical account balance at the end of 2017 (which is the end of the last interest crediting period that ends on or before the January 27, 2018, plan termination date).

(ii) *Conclusion*. Because Plan B credited interest prior to 2016 using the rate of return on a RIC (a rate described in paragraph (d)(5) of this section), for purposes of determining the average interest crediting rate upon plan termination, the interest crediting rate used to determine accrued benefits under Plan B for all participants during those periods (for the calendar years 2013, 2014, and 2015) is equal to the second segment rate for December of the calendar year preceding each interest crediting period. In addition, because the pre-2016 balances exceeded the ongoing hypothetical account balance for 10 participants in the last interest crediting period prior to plan termination, for purposes of determining the average interest crediting rate upon plan termination, the interest crediting rate used to determine accrued benefits under Plan B for 2016 and 2017 for those participants is equal to the second segment rate for December 2015 and December 2016, respectively. For all other participants, for purposes of determining the average interest crediting rate upon plan termination, the interest crediting rate used to determine accrued benefits under Plan B for 2016 and 2017 is based on the ongoing interest crediting rate (as described in *Example 4*).

(3) * * * (i) * * * The right to future interest credits determined in the manner specified under the plan and not conditioned on future service is a factor that is used to determine the participant's accrued benefit, for purposes of section 411(d)(6). * * * Paragraphs (e)(3)(ii) through (e)(3)(vi) of this section set forth special rules that apply regarding the interaction of section 411(d)(6) and changes to a plan's interest crediting rate. * * *

(ii) * * *

(B) The effective date of the amendment is at least 30 days after adoption of the amendment;

(C) On the effective date of the amendment, the new interest crediting rate is not lower than the interest crediting rate that would have applied in the absence of the amendment; and

(D) For plan years that begin on or after January 1, 2016, if prior to the amendment the plan used a fixed annual floor in connection with a rate described in paragraph (d)(4)(ii), (iii) or (iv) of this section (as permitted under paragraph (d)(6)(ii) of this section), the floor is retained after the amendment to the maximum extent permissible under paragraph (d)(6)(ii)(A) of this section.

(iii) *Coordination of section 411(d)(6) and market rate of return limitation*—(A) *In general*. An amendment to a statutory hybrid plan that preserves a section 411(d)(6) protected benefit is subject to the rules under paragraph (d) of this section relating to market rate of return. However, in the case of an amendment to change a plan's interest crediting rate for periods after the applicable amendment date from one interest crediting rate (the old rate) that satisfies the requirements of paragraph (d) of this section to another interest crediting rate (the new rate) that satisfies the requirements of paragraph (d) of this section, the plan's effective interest crediting rate is not in excess of a market rate of return for purposes of paragraph (d) of this section merely because the plan provides for the benefit of any participant who is benefiting under the plan (within the meaning of § 1.410(b)–3(a)) on the applicable amendment date to never be less than what it would be if the old rate had continued but without taking into account any principal credits (as defined in paragraph (d)(1)(ii)(D) of this section) after the applicable amendment date.

(B) *Multiple amendments*. A pattern of repeated plan amendments each of which provides for a prospective change in the plan's interest crediting rate with respect to the benefit as of the applicable amendment date will be treated as resulting in the ongoing plan terms providing for an effective interest crediting rate that is in excess of a market rate of return. See § 1.411(d)–4, A–1(c)(1).

(iv) *Change in lookback month or stability period used to determine interest credits*—(A) *Section 411(d)(6) anti-cutback relief*. With respect to a plan using an interest crediting rate described in paragraph (d)(3) or (d)(4) of this section, notwithstanding the general rule of paragraph (e)(3)(i) of this section, if a plan amendment changes the lookback month or stability period used to determine interest credits, the amendment is not treated as reducing accrued benefits in violation of section 411(d)(6) merely on account of this change if the conditions of this paragraph (e)(3)(iv)(A) are satisfied. If the plan amendment is effective on or after the adoption date, any interest credits credited for the one-year period commencing on the date the amendment is effective must be determined using the lookback month and stability period provided under the plan before the amendment or the lookback month and stability period after the amendment, whichever results in the larger interest credits. If the plan amendment is adopted retroactively (that is, the amendment is effective prior to the adoption date), the plan must use the lookback month and stability period resulting in the larger interest credits for the period beginning with the effective date and ending one year after the adoption date.

(B) *Section 411(b)(5)(B)(i)(I) market rate of return relief*. The plan's effective interest crediting rate is not in excess of a market rate of return for purposes of paragraph (d) of this section merely because a plan amendment complies with the requirements of paragraph (e)(3)(iv)(A) of this section. However, a pattern of repeated plan amendments each of which provides for a change in the lookback month or stability period used to determine interest credits will be treated as resulting in the ongoing plan terms providing for an effective interest crediting rate that is in excess of a market rate of return. See § 1.411(d)–4, A–1(c)(1).

(v) *RIC ceasing to exist*. This paragraph (e)(3)(v) applies in the case of a statutory hybrid plan that credits interest using an interest crediting rate equal to the rate of return on a RIC (pursuant to paragraph (d)(5)(iv) of this section) that ceases to exist, whether as a result of a name change, liquidation, or otherwise. In such a case, the plan is not treated as violating section 411(d)(6) provided that the rate of return on the successor RIC is substituted for the rate of return on the RIC that no longer exists, for purposes of crediting interest for periods after the date the RIC ceased to exist. In the case of a name change or merger of RICs, the successor RIC means the RIC that results from the name change or merger involving the RIC that no longer exists. In all other cases, the successor RIC is a RIC selected by the plan sponsor that has reasonably similar characteristics, including characteristics related to risk and rate of return, as the RIC that no longer exists.

(4) *Actuarial increases after normal retirement age*. A statutory hybrid plan is not treated as providing an effective interest crediting rate that is in excess of a market rate of return for purposes of paragraph (d) of this section merely because the plan provides that the participant's benefit, as of each annuity starting date after normal retirement age, is equal to the greater of—

(i) The benefit based on the accumulated benefit determined using an interest crediting rate that is not in excess of a market rate of return under paragraph (d) of this section; and

(ii) The benefit that satisfies the requirements of section 411(a)(2).

(5) *Plans that permit participant direction of interest crediting rates*. [Reserved]

* * * * *

(f) * * *

(2) * * *

(i) * * *

(B) *Special effective date*. Paragraphs (d)(1)(iii), (d)(1)(iv)(D), (d)(1)(vi), (d)(2)(ii), (d)(4)(v), (d)(5)(ii)(B), (d)(5)(iv), (d)(6), (e)(2), (e)(3)(iii), (e)(3)(iv), (e)(3)(v) and (e)(4) of this section apply to plan years that begin on or after January 1, 2016 (or an earlier date as elected by the taxpayer).

* * * * *

John Dalrymple
Deputy Commissioner for Services and Enforcement.

Approved September 15, 2014.

Mark J. Mazur
Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on September 18, 2014, 8:45 a.m., and published in the issue of the Federal Register for September 19, 2014, 79 F.R. 56442)

Section 162.—Trade or Business Expense

26 CFR 1.162–31: Allowable deduction for remuneration attributable to services performed by applicable individuals to certain health insurance providers that receive premiums from providing health insurance coverage

T.D. 9694

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

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

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final 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 certain health insurance providers providing remuneration that exceeds the deduction limitation.

DATES: *Effective Date*: These regulations are effective on September 23, 2014.

Applicability Date: For dates of applicability, see § 1.162–31(j).

FOR FUTHER INFORMATION CONTACT: Ilya Enkishev at (202) 317-5600 (not a toll-free number).

SUPPLEMENTARY INFORMATION

Background

This document contains final amendments to the Income Tax Regulations (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 performed 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)).

In general, section 162(m)(6) limits to $500,000 the allowable deduction for remuneration attributable to services performed by an applicable individual for a covered health insurance provider in a 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 and the final regulations as remuneration that is otherwise deductible). Remuneration attributable to services performed for a covered health insurance provider in a disqualified taxable year beginning after December 31, 2009, and before January 1, 2013, that becomes otherwise deductible in a taxable year 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. If 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.

On December 23, 2010, the Department of the Treasury (Treasury Department) and the IRS released Notice 2011–2 (2011–1 IRB 260), which provides guidance on certain issues under section 162(m)(6). A notice of proposed rulemaking (REG–106796–12) was published in the **Federal Register** (78 FR 19950) on April 2, 2013 (the proposed regulations). The Treasury Department and the IRS received written comments in response to the notice and the proposed regulations. After consideration of these comments, the Treasury Department adopts the proposed regulations as final regulations, with the modifications set forth in this Treasury decision.

Summary of Comments and Explanation of Modifications

I. *Definition of 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). A person may be a covered health insurance provider for one taxable year, but not be 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. These final regulations generally adopt the rules described in the proposed regulations for determining whether a health insurance issuer or any other person is a covered health insurance provider for any taxable year, except as described herein.

B. *Health Insurance Issuers*

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 it 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)). 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 it receives premiums from providing health insurance coverage (as defined in section 9832(b)(1)) during the taxable year.

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

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, sections 1563(a)(2) and (3) (describing brother-sister controlled groups and combined groups) are disregarded. The final regulations, like the proposed regulations, generally provide that each member of an aggregated group that includes a covered health insurance provider 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. For this purpose, the final regulations, like the 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) and (d) (with respect to trades or businesses under common control).

The proposed regulations include rules for determining 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 of an aggregated group is generally a covered health insurance provider for its taxable year with which, or in which, ends the taxable year of any health insurance issuer that is a covered health insurance provider in an aggregated group with the parent entity. Each other member of the parent entity's 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. The final regulations generally adopt these rules.

The final regulations, like the proposed regulations, provide that, in 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)), the parent entity is the common parent of the aggregated group.

With respect to an aggregated group that is an affiliated service group within the meaning of section 414(m) or a group described in section 414(o), the final regulations adopt the rules described in the proposed regulations and provide that the parent entity is the health insurance issuer in the aggregated group. If, however, 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 a group described in section 414(o), then any health insurance issuer in the aggregated group that is designated in writing by the other members of the aggregated group is the parent entity for purposes of section 162(m)(6). If the members of an aggregated group that includes two or more health insurance issuers that is an affiliated service group or group described in section 414(o) fail to designate a parent entity in writing, the members of the group are deemed for all taxable years to have a parent entity with a taxable year that is the calendar year.

In the preamble to the proposed regulations, the Treasury Department and the IRS requested comments on the circumstances under which a new parent entity could be designated, such as when a health insurance issuer that has been designated as the parent entity of an aggregated group ceases to be a member of the aggregated group as a result of a corporate transaction, and any transition rules that may be necessary in such situation. One commenter suggested that the final regulations should provide that when a parent entity (a *predecessor parent entity*) ceases to be a member of an aggregated group under section 414(m) and another health insurance issuer that has the same taxable year as the predecessor parent entity remains in the aggregated group, the remaining members of the aggregated group must designate that health insurance issuer as the new parent entity (the *successor parent entity*). The commenter also suggested that if no health insurance issuer remaining in the aggregated group has the same taxable year as the predecessor parent entity, then the group should be permitted to designate any health insurance issuer in the aggregated group as the successor parent entity. The final regulations generally adopt these suggestions.

The final regulations also provide transition rules for determining when a member of an aggregated group is a covered health insurance provider if, as a result of a change in the identity of the parent entity or for any other reason, the taxable year of the parent entity is less than 12 consecutive months. The final regulations provide that if the taxable year of the parent entity is less than 12 months, then, solely for purposes of determining whether it is a covered health insurance provider for its short taxable year and for purposes of determining whether each other member of the parent entity's aggregated group is a covered health insurance provider for its taxable year ending with or within the taxable year of the parent entity, the taxable year of the parent entity is treated as the 12-month period ending on the last day of its short taxable year. The purpose of this rule is to ensure consistency and continuity in the treatment of members of an aggregated group as covered health insurance providers. Without this rule, certain members of an aggregated group that are generally treated as covered health insurance providers may not be treated as covered health insurance providers for one taxable year because they do not have a taxable year ending with or within the short taxable year of the parent entity.

One commenter suggested that an entity should not be a covered health insurance provider if all of the services performed by its employees and independent contractors are unrelated to the direct or indirect generation of health insurance premiums and if the entity is geographically separate from any entity within the aggregated group that receives premiums from providing health insurance. These final regulations do not adopt this suggestion. Such a rule would be inconsistent with section 162(m)(6)(C)(ii), which provides that all members of an aggregated group that includes a health insurance issuer described in section 162(m)(6)(C)(i) are covered health insurance providers.

D. *United States Possessions*

One commenter suggested that health insurance providers located in Puerto Rico should not be considered health insurance issuers under section 9832(b)(1) and, therefore, should not be covered health insurance providers under section 162(m)(6)(C)(i). The commenter also suggested that health insurance companies (and similar health insurance providers) located in Puerto Rico should not be considered covered health insurance providers under section 162(m)(6)(C) because the benefits of the ACA do not inure to Puerto Rican insurance companies and because American taxpayers do not subsidize compensation paid by health insurance providers in Puerto Rico through tax deductions. These final regulations do not adopt this suggestion. In regulations issued under section 9010 of the ACA (TD 9643, 78 FR 71476, November 29, 2013), the Treasury Department and the IRS concluded that a health insurance company, health insurance service, or insurance organization may be a health insurance issuer under section 9832(b)(2) even if it is located in Puerto Rico. Accordingly, a health insurance issuer that is otherwise a covered health insurance provider under section 162(m)(6) will not fail to be a covered health insurance provider solely because it is located in Puerto Rico.

E. *Self-insurers*

These final regulations, like the 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, and may include a plan maintained by an employee organization described in section 501(c)(9).

One commenter noted that, in addition to providing a self-insured medical reimbursement plan, some employers provide coverage for other health care costs through an insurance policy (for example, through separate insured coverage for prescription drugs). The commenter requested clarification that an employer that maintains a self-insured medical reimbursement plan will not be a covered health insurance provider solely because the employer provides additional coverage through an insurance policy. The Treasury Department and the IRS agree that this is correct.

F. *De Minimis Exception*

The final regulations retain the *de minimis* exception described in the proposed regulations with certain clarifications. The final regulations provide that a person that would otherwise be a covered health insurance provider under section 162(m)(6)(C)(i)(II) for any taxable year beginning after December 31, 2012, is not 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 is 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. For taxable years beginning after December 31, 2009, and before January 1, 2013, a person that would otherwise be a covered health insurance provider under section 162(m)(6)(C)(I) is not 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.

Commenters suggested that the two-percent threshold for the *de minimis* exception should be increased to a level as high as five percent. In response to Notice 2011–2, which requested comments on the *de minimis* exception, some commenters requested that the threshold not be increased because a higher threshold would allow health insurance issuers that sell significant amounts of health coverage to be exempt from the deduction limit under section 162(m)(6) and thereby provide them with a competitive advantage. After careful consideration of all comments on the *de minimis* exception, the Treasury Department and the IRS have concluded that the two-percent threshold strikes the appropriate balance between exempting persons that receive health insurance premiums that are insignificant in relation to their overall activities and ensuring that persons that sell a significant amount of health insurance are not exempted from the deduction limitation. Accordingly, the final regulations do not adopt the suggestion to increase the *de minimis* threshold.

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)). The proposed regulations provide 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). The final regulations generally adopt the rules set forth in the proposed regulations.

B. *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.

The final regulations follow the proposed regulations, and 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 from providing health insurance coverage 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. In the preamble to the proposed regulations, the Treasury Department and the IRS requested comments on whether capitated, prepaid, or periodic payments made by a government entity to a third party to provide, manage, or arrange for the provision of services by physicians, hospitals, or other healthcare providers should be treated as premiums from providing health insurance coverage for purposes of section 162(m)(6).

One commenter suggested that payments from a government entity to certain medical care providers that accept risk-based payments in exchange for providing medical care (referred to in this preamble as clinical risk-bearing entities) should not be treated as premiums from providing health insurance coverage. The commenter observed that the term *health insurance coverage* is defined in section 9832(b)(1) as "benefits consisting of medical care (provided directly, through insurance or reimbursement, or otherwise) under any hospital or medical service policy or certificate, hospital or medical service plan contract, or health maintenance organization contract offered by a health insurance issuer." The commenter asserted that clinical risk-bearing entities do not provide health insurance coverage under section 9832(b)(1) because they do not issue policies, certificates, or contracts of insurance to the individuals to whom they provide medical care. Specifically, the commenter suggested that capitated payments under the Medicare Shared Savings program or the Medicare Pioneer ACO Program to a clinical risk-bearing entity should not be treated as premiums from providing health insurance coverage for this reason.

The commenter further noted that the definition of the term *health insurance coverage* was added to the Code in 1996 as part of the market reforms under the Health Insurance Portability and Accountability Act (HIPAA) and that virtually identical definitions of the term health insurance coverage were added to the Public Health Service Act (PHSA) and the Employee Retirement Income Security Act (ERISA) at that time. The commenter pointed out that the Secretaries of the Treasury Department, Health and Human Services (HHS), and the Department of Labor (DOL) are required to administer the definitions of the term health insurance coverage consistently in all three statutes pursuant to section 104 of HIPAA.

The commenter also noted that the Centers for Medicare and Medicaid Services (CMS) have published guidance indicating that payments made by a health insurance issuer to a clinical risk-bearing entity may qualify as incurred claims for purposes of determining the issuer's Medical Loss Ratio under certain circumstances. See CMS, CCIIO Technical Guidance (CCIIO 2012–001): Questions and Answers Regarding the Medical Loss Ratio Interim Final Rule (February 10, 2012). According to the commenter, the treatment of payments to a clinical risk-bearing entity as incurred claims suggests that such payments are not premiums from providing health insurance coverage. The commenter urged the Treasury Department and the IRS to clarify that clinical risk-bearing entities are not covered health insurance providers subject to the deduction limitation under section 162(m)(6) unless they offer policies, certificates, or contracts of insurance to enrollees.

Another commenter asserted that Medicaid managed care organizations (MCOs) and providers of Medicare Advantage and Medicare Part D prescription drug plans should not be considered health insurance issuers that provide health insurance coverage for purposes of sections 9832(b)(1) and (2) and 162(m)(6). Like the other commenter, this commenter also pointed to guidance issued by CMS to support its position. See CMS, CCIIO Technical Guidance (CCIIO 2012–002): Questions and Answers Regarding the Medical Loss Ratio Regulation (April 20, 2012). The commenter urged the Treasury Department and the IRS to treat fees paid to companies with healthcare business under governmental healthcare programs, including Medicare and Medicaid, as direct service payments, and not as premiums for purposes of determining whether a person is a health insurance issuer that provides health insurance coverage for purposes of Code section 162(m)(6).

The Treasury Department and the IRS agree with the commenters that a person cannot be a covered health insurance provider under section 162(m)(6) unless it is a health insurance issuer within the meaning of section 9832(b)(2) that receives premiums from providing health insurance coverage within the meaning of section 9832(b)(1). The Treasury Department and the IRS also acknowledge that section 104 of HIPAA generally requires the Treasury Department, HHS, and DOL to interpret consistently the terms *health insurance issuer* and *health insurance coverage*, as used in the Code, the PHSA, and ERISA.

The Treasury Department and the IRS, however, do not adopt the suggestion to provide in the final regulations that clinical risk bearing entities, Medicare and Medicaid providers, and other recipients of payments from government entities in connection with providing benefits under government sponsored health care programs are not covered health insurance providers or that the amounts received by these organizations are not premiums from providing health insurance coverage.

The commenters correctly observe that to be a covered health insurance provider under section 162(m)(6), a person must be a health insurance issuer (as defined in section 9832(b)(2)) that provides health insurance coverage (as defined in section 9832(b)(1)) and meets certain other requirements. If the person is not a health insurance issuer or does not receive premiums from providing health insurance coverage, the person is not a covered health insurance provider.

The definitions of the terms *health insurance coverage* and *health insurance issuer* have significant importance in many sections of the Code, the PHSA, and ERISA. The Treasury Department and the IRS have concluded that it would be inappropriate to provide broad guidance on the interpretation of sections 9832(b)(1) and 9832(b)(2) because it would require full consideration of the possible effects of that guidance on other statutory provisions. The consideration of these wide-ranging implications is outside of the scope of these regulations under section 162(m)(6). However, additional guidance on the meaning of the terms *health insurance issuer* and *health insurance coverage* may be provided in future regulations, notices, revenue rulings, or other guidance of general applicability published in the Internal Revenue Bulletin.

C. *Stop-Loss Coverage*

Stop-loss coverage allows an employer to self-insure for a set amount of claims costs, with the stop-loss coverage covering all or most of the claims costs that exceed the set amount. Several commenters requested that the final regulations clarify the treatment of stop-loss coverage. Specifically, commenters suggested that payments for stop-loss coverage not be treated as premiums from providing health insurance coverage because stop-loss coverage does not provide insurance coverage for the health risk of an individual or for medical care for an individual. Other commenters suggested that the final regulations adopt the model standards of the National Association of Insurance Commissioners for determining whether payments for stop-loss insurance coverage qualify as premiums from providing health coverage.

The DOL, HHS, and the Treasury Department have expressed concern that employers in small group markets with healthier employees may pursue nominally self-insured arrangements with stop-loss coverage at low attachment points as functionally equivalent alternatives to insured group health plans. The three agencies issued a request for information regarding such practices, with a focus on the prevalence and consequences of stop-loss coverage at low attachment points. 77 FR 25788 (May 1, 2012). Because the scope of stop-loss coverage that may constitute health insurance, if any, has not been determined, premiums under a stop-loss contract will not be considered premiums from providing health insurance coverage for purposes of section 162(m)(6) until such time and to the extent that future guidance addresses the issue of whether and, if so, under what circumstances, stop-loss coverage constitutes health insurance.

D. *Captive Insurance Companies*

Under the final regulations, as under the proposed regulations, a captive insurance company is a covered health insurance provider if it is a health insurance issuer that is otherwise described in section 162(m)(6)(C). One commenter recommended that premiums received by a captive insurance company or other health insurance issuer that are attributable to coverage provided for current and former employees of members of an aggregated group that includes the captive insurance company or other health insurance issuer should be excluded from the definition of premiums. The commenter also suggested that premiums received by a health insurance issuer for providing health insurance coverage to current and former employees of other related businesses outside of the health insurance issuer's aggregated group should be excluded from the definition of premiums under certain circumstances. The final regulations do not adopt these suggestions.

Section 406 of ERISA generally prohibits transactions between an employee benefit plan and a party in interest, and, under Section 3(14)(C) of ERISA, employers are generally parties in interest with respect to the plans that they sponsor. In addition, Section 3(14)(G) of ERISA provides that entities that are more than 50 percent owned by employers are also parties in interest. Accordingly, captive insurance companies that are more than 50 percent owned by the sponsor of an employee benefit plan are generally parties in interest, and the payment of premiums to such a captive insurance company to provide insurance to an employee benefit plan maintained by the owner of a captive insurance company would generally be a prohibited transaction and be subject to an excise tax under section 4975.

The DOL, however, has granted a prohibited transaction class exemption and numerous individual prohibited transaction exemptions that apply to captive insurance arrangements in certain circumstances. Under the class exemption, a captive insurance company can directly insure the employee benefit plan risks of a related employer if the captive insurance company and the arrangement meet certain requirements, one of which is that at least 50 percent of the captive insurer's business is unrelated to the employer sponsor of the plan.

The individual exemptions apply to circumstances in which a captive insurance company provides reinsurance to an unrelated insurance company that directly insures the health risks of a plan sponsor's employees. Under this type of arrangement, an employer purchases health insurance for its employees through an unrelated insurance company and pays premiums for that coverage to the unrelated insurance company. The unrelated insurance company then reinsures these health risks through the employer's captive insurance company under an indemnity reinsurance arrangement.

It is the understanding of the Treasury Department and the IRS that employers insuring the health risks of their employees through captive insurance companies generally use the approach outlined in the individual exemptions to avoid engaging in a prohibited transaction and incurring an excise tax under section 4975. Because the amounts received by a captive insurance company under this type of arrangement are solely payments for providing indemnity reinsurance, those payments are not treated as premiums under existing provisions of these regulations, and no special rule is needed for these types of payments. In the case of captive insurance arrangements that rely on the class exemption, the Treasury Department and the IRS have concluded that a special rule for premiums paid by a plan sponsor or its related businesses or their employees would be inappropriate because the captive insurance company would be required under the terms of the class exemption to conduct a significant portion of its insurance business with unrelated third parties.

The commenter acknowledged that captive insurance companies generally follow the approach outlined in the DOL's individual prohibited transaction exemptions but asserted that an exemption for captive insurance companies is nonetheless necessary because the law in this area may change in the future to permit captive insurance companies to receive significant premium payments directly from a related employer. The Treasury Department and the IRS have concluded that a special exception is not necessary at this time for amounts paid to captive insurance companies.

III. *Disqualified Taxable Year*

Consistent with section 162(m)(6)(B) and the proposed regulations, the final regulations provide that a disqualified taxable year is, with respect to any employer, any taxable year for which the employer 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. The final regulations adopt the proposed regulations and provide that remuneration for services performed by an independent contractor to a covered health insurance provider will not be subject to the deduction limitation under section 162(m)(6) if certain conditions are met. The conditions that must be met under the final regulations for the independent contractor exception to apply are the same as those provided in the proposed regulations.

Section 162(m)(6)(F) defines an applicable individual as an "individual" described in that section. Therefore, a corporation, partnership, or other entity that is not a natural person generally would not be an applicable individual. The preamble to the proposed regulations explains that the Treasury Department and the IRS are 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. In the preamble to the proposed regulations, the Treasury Department and the IRS invited comments regarding how the final regulations might address this potential abuse.

One commenter suggested that if a covered health insurance provider reports remuneration payments on a Form 1099 or W–2 issued directly to a natural person, then that person should be the service provider for purposes of section 162(m)(6). Conversely, if a covered health insurance provider reports remuneration as having been paid to an entity other than a natural person, and that reporting is not found to be incorrect under section 6041, the entity should be the recipient of the remuneration for purposes of section 162(m)(6).

The final regulations do not adopt these suggestions. In general, section 6041 requires information reporting for payments to independent contractors and employees. The purpose of section 6041 is simply to track payments that may constitute gross income to the payee. Section 6041 information reporting does not typically require the payor to look beyond the identity of the recipient of a payment. Accordingly, it would be inappropriate to rely on section 6041 information reporting to identify potentially abusive arrangements.

The Treasury Department and the IRS remain concerned about employment arrangements that may be structured for the purpose of avoiding the deduction limitation under section 162(m)(6). Accordingly, while the final regulations recognize that an applicable individual generally will be a natural person, they provide that the Treasury Department and the IRS may issue guidance in the future identifying situations in which services performed by an entity will be treated as services performed by an individual for purposes of section 162(m)(6).

V. *Applicable Individual Remuneration (AIR)*

As required under section 162(m)(6)(D), the final regulations, like the proposed regulations, provide that AIR is the aggregate amount that is allowable as a deduction (determined without regard to section 162(m)) with respect to an applicable individual for a disqualified taxable year for remuneration for services performed by that individual (whether or not during the taxable year), except that AIR does not include any amount that is deferred deduction remuneration.

VI. *Deferred Deduction Remuneration (DDR)*

Section 162(m)(6)(E) and the final regulations, like the proposed regulations, provide that DDR is remuneration that would be AIR 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).

VII. *Attribution of Remuneration to Services Performed in Taxable Years*

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

A. *In General*

The final regulations, like the proposed regulations, provide that, except as otherwise specifically provided in the regulations, 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. In addition, the final regulations, like the proposed regulations, provide that remuneration is not attributable to a taxable year during which the applicable individual is not a service provider. For these purposes, an individual is a service provider of a covered health insurance provider for any period during which the individual is an officer, director, or employee of, or providing services for, or on behalf of, the covered health insurance provider or any member of its aggregated group.

In the preamble to the proposed regulations, the Treasury Department and the IRS requested comments on an appropriate method for attributing increases in an applicable individual's benefit that accrue in taxable years of a covered health insurance provider beginning after the applicable individual ceases providing services (referred to in this preamble as post-termination remuneration) to taxable years during which the applicable individual was a service provider. Comments were specifically requested on the appropriate methods for attributing increases under an account balance plan (defined as a plan described in § 1.409A–1(c)(2)(i)(A) or (B)) and a nonaccount balance plan (defined as a plan described in § 1.409A–1(c)(2)(i)(C)). In the context of nonaccount balance plans, one commenter suggested that each payment to or on behalf of an applicable individual under a nonaccount balance plan should be attributed to taxable years of a covered health insurance provider during which the applicable individual was a service provider in proportion to the increase in the applicable individual's benefit under the plan during those years. For example, if an applicable individual is a service provider for a covered health insurance provider for two years and participates in a deferred compensation plan during that time, and the applicable individual's benefit under the plan increases by an equal amount in both of those years, then 50 percent of each payment under the plan (whenever the payment is made and even if it includes post-termination remuneration) would be attributable to services performed in each of the two taxable years. According to the commenter, this method would provide a relatively simple method for attributing payments, including payments that include post-termination remuneration, to services performed in taxable years of a covered health insurance provider.

The Treasury Department and the IRS agree with the commenter that this approach to the attribution of deferred compensation payments will ease administration for taxpayers and the IRS and will result in a consistent and principled attribution of payments to taxable years during which an applicable individual is a service provider. Although the commenter proposed this attribution method in the context of nonaccount balance plans, the Treasury Department and the IRS have concluded that this approach is an appropriate method for attributing amounts that become otherwise deductible under account balance plans as well. Accordingly, the Treasury Department and the IRS generally adopt this approach to the attribution of payments from account balance plans and nonaccount balance plans.

B. *Account Balance Plans*

The proposed regulations provide two methods for attributing remuneration under an account balance plan to services performed by an applicable individual in a taxable year of the covered health insurance provider. The proposed regulations refer to these methods as the standard attribution method and the alternative 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. To the extent that an amount that becomes otherwise deductible under an account balance plan (such as a payment) could be attributed to services performed by an applicable individual in two or more taxable years of a covered health insurance provider, the proposed regulations provide that 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.

The proposed regulations also provide that, under the standard attribution method, any increases or decreases in an account balance that occur in taxable years of a covered health insurance provider in which an applicable individual is not a service provider must be attributed to taxable years during which the applicable individual is a service provider and has an account balance under the plan. The preamble to the proposed regulations provides that for taxable years beginning in 2013, and thereafter until the Treasury Department and the IRS issue further guidance prescribing the method for attributing post-termination remuneration to these taxable years, post-termination remuneration may be attributed using any reasonable method to taxable years of a covered health insurance provider during which an applicable individual is a service provider and has 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.

Under the alternative method described in the proposed regulations, an amount paid to or on behalf of an applicable individual from an account balance plan is attributable to services performed by the applicable individual in the taxable year of a covered health insurance provider in which the principal addition related to the amount was credited to the applicable individual's account under the plan. To the extent that an amount paid from the plan includes earnings on a principal addition (including post-termination remuneration), the amount is attributable to services performed in the taxable year in which the principal addition was credited to the account.

The final regulations also provide that two methods are available for attributing remuneration under account balance plans. One method, which is different from the methods described in the proposed regulations, is referred to as the account balance ratio method, and the other, which is similar to the alternative method described in the proposed regulations, is referred to as the principal additions method. The final regulations, like the proposed regulations, provide that a covered health insurance provider and each member of its aggregated group must use the same method consistently to attribute remuneration under all of its account balance plans for all taxable years, with certain limited exceptions.

1. *Account Balance Ratio Method*

The account balance ratio method is based on the proportional attribution principles described previously in section VII.A of this preamble. However, it is similar to the standard attribution method described in the proposed regulations in that the amount attributed to services performed by an applicable individual in a particular taxable year of a covered health insurance provider is based on the increase in the applicable individual's account balance during that year. Under the account balance ratio method, remuneration that becomes otherwise deductible (for example, because it is paid or made available to or for an applicable individual) is attributed to services performed by the applicable individual in each taxable year of the covered health insurance provider in which the applicable individual was a service provider and for which the account balance increased. The amount attributed to each of these taxable years is equal to the total amount that becomes otherwise deductible for the year multiplied by a fraction. The numerator of the fraction is the increase in the account balance for that taxable year, and the denominator of is the sum of all increases in the account balance for all taxable years during which the applicable individual was a service provider.

For this purpose, an increase in an account balance occurs for a taxable year only if the account balance on the last day of the taxable year is greater than the highest account balance on the last day of every prior taxable year. The amount of the increase for any taxable year is the excess of the account balance as of the last day of the taxable year over the highest account balance as of the last day of any prior taxable year.

For example, if an applicable individual's account balance is $10x on the last day of Year 1, $5x on the last day of Year 2, $7x on the last day of Year 3, and $12x on the last day of Year 4, with the fluctuations due solely to changes in investment returns and not due to payments under the plan, the only year in which an increase occurs is Year 4, and the increase is equal to $2x ($12x − $10x (the highest account balance in a prior year)). For post-termination payments, the account balance ratio for each taxable year will generally remain constant, and the same ratios will generally apply to all future payments. The Treasury Department and the IRS anticipate that this method will be significantly easier to administer than the standard attribution method described in the proposed regulations.

Under the account balance ratio method, certain adjustments are made to account balances for in-service payments and for the payment of grandfathered amounts (as described in section XI of this preamble). For this purpose, an in-service payment is any payment made in a taxable year during which an applicable individual is a service provider, and it includes a payment made after an applicable individual permanently ceases to be a service provider (for example, because the applicable individual retires) if the applicable individual was a service provider at any time during the taxable year of the covered health insurance provider in which the payment was made. These adjustments are necessary because an in-service payment that is made from an account balance plan during a year when an applicable individual is accumulating benefits would reduce or eliminate any increase in the year-end account balance that would have occurred in the absence of the in-service payment. The adjustments required for in-service payments and grandfathered amounts are intended to eliminate this effect.

Under the account balance ratio method, if an applicable individual obtains a legally binding right in a taxable year during which the applicable individual is a service provider to an additional contribution under the plan (other than earnings) that will be made in a taxable year in which the applicable individual is not a service provider, the additional contribution is attributed to services performed in the first taxable year preceding the taxable year of the contribution in which the applicable individual was a service provider.

In response to the request for comments in the proposed regulations on an appropriate method for attributing post-termination earnings to taxable years in which an applicable individual is a service provider, one commenter suggested that any increases (or decreases) in an account balance that occur in taxable years in which an applicable individual is not a service provider should be attributed *pro rata* beginning with the taxable year in which the applicable individual begins participating in the plan and ending with the taxable year in which the individual ceases to be a service provider. The final regulations do not adopt this suggestion because it could result in an allocation of earnings largely unrelated to the years in which amounts were credited under the plan as remuneration for services performed.

2. *Principal Additions Method*

The alternative method described in the proposed regulations provides that a principal addition and earnings (or losses) thereon (including earnings and losses in taxable years during which an applicable individual is not a service provider) are attributed to the taxable year in which the related principal addition is made (including earnings and losses that occur in taxable years during which an applicable individual is not a service provider). The final regulations generally adopt the alternative method with certain modifications and refer to it as the principal additions method.

Under the principal additions method, earnings on a principal addition (including post-termination earnings) 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 in the 2015 taxable year, earnings on that principal addition in 2028 are treated as additional remuneration for the 2015 taxable year, and not the 2028 taxable year.

When an amount is paid from an account balance plan, it is attributed under the principal additions method to services performed in the taxable year in which the principal addition to which the amount relates was credited under the plan. The final regulations clarify that the principal additions method is available only for account balance plans that separately account for each principal addition to the plan and any earnings thereon and that can trace any amount that becomes otherwise deductible under the plan, through separate accounting, to a principal addition made in a taxable year of a covered health insurance provider. The Treasury Department and the IRS understand that certain plans already track contributions of principal additions and the earnings thereon from the time those principal additions are credited under the plan to the time they are paid, generally as part of the administration of the plan's method of compliance with section 409A. The ability to trace payments from the plan to principal additions made in a particular taxable year is integral to the purpose of this attribution method, and the Treasury Department and the IRS believe it is appropriate to limit the use of this method to plans that maintain the separate accounting necessary to trace these amounts.

C. *Nonaccount Balance Plans*.

The proposed regulations provide that remuneration under a nonaccount balance plan is attributable to services performed by an applicable individual in a taxable year based on the increase 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 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. To the extent that an amount that becomes otherwise deductible under a nonaccount balance plan (such as a payment) could be attributed to services performed by an applicable individual in two or more taxable years of a covered health insurance provider, the proposed regulations provide that 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.

In response to comments, the final regulations adopt two different attribution methods for nonaccount balance plans based on proportional attribution principles and provide that a covered health insurance provider may choose either of these two methods to attribute remuneration to taxable years under a nonaccount balance plan. These two methods are referred to in the final regulations as the present value ratio method and the formula benefit ratio method. A covered health insurance provider and each member of its aggregated group must use the same method consistently to attribute remuneration under all of their nonaccount balance plans consistently for all taxable years, with certain limited exceptions.

1. *Present Value Ratio Method*.

Under the present value ratio method, each time an amount becomes otherwise deductible, such as when a payment is made under the plan, the amount is attributed to services performed in a taxable year or years of a covered health insurance provider during which an applicable individual was a service provider and for which there was an increase in the present value of payment(s) due under the plan. The amount attributed to each of these taxable years is equal to the total amount that is otherwise deductible multiplied by a fraction. The numerator of the fraction is the increase in the present value of the applicable individual's benefit for the taxable year, and the denominator of the fraction is the sum of all such increases in present value for all taxable years during which the applicable individual was a service provider. In other words, each time an amount becomes otherwise deductible, the amount is attributed proportionately to each taxable year in which the applicable individual was a service provider based on the increase in the present value of the applicable individual's benefit under the plan during that year.

For purposes of the present value ratio method, an increase in the present value of an applicable individual's benefit occurs for a taxable year only if the present value of the benefit on the last day of the covered health insurance provider's taxable year is greater than the present value of the benefit on the last day of every prior taxable year. The amount of the increase for the taxable year is the excess of the present value of the benefit on the last day of the taxable year over the greatest present value of the benefit on the last day of any prior taxable year. If the present value of the applicable individual's benefit as of the last day of the taxable year is less than or equal to the present value of the benefit on the last day of any prior taxable year, there is no increase in the present value for that year for purposes of this calculation. For purposes of determining the present value of a future payment or payments, the rules of § 31.3121(v)(2)–1(c)(2) apply. Like the rules under the account balance ratio method, the final regulations also provide for adjustments in the present value of an applicable individual's benefit to the extent that the present value is reduced by in-service payments or includes grandfathered amounts.

Although the present value ratio method adopts proportional attribution principles for purposes of attributing each payment to services performed by an applicable individual in taxable years of a covered health insurance provider, it is similar to the attribution method for nonaccount balance plans described in the proposed regulations in that amounts paid from the plan are attributed to taxable years based on an increase in the present value of the applicable individual's benefit. The Treasury Department and the IRS believe that the present value ratio method will be significantly easier for both taxpayers and the IRS to administer than the nonaccount balance attribution method described in the proposed regulations. For applicable individuals who begin receiving benefits under a nonaccount balance plan after termination of employment, the present value ratio for each taxable year will generally remain constant, and the payments can be attributed to a taxable year or years simply by multiplying the amount of the payment by the applicable fraction or percentage.

2. *Formula Benefit Ratio Method*.

In response to the request for comments on the attribution method for nonaccount balance plans set forth in the proposed regulations, one commenter suggested that covered health insurance providers should not be required to determine the present value of an applicable individual's benefit for each taxable year to determine the taxable years to which an amount should be attributed. The commenter observed that plans do not ordinarily determine the present value of benefits on an individual basis before amounts are paid, if ever, and that this calculation would add significant complexity to process for attributing payments to services performed. The commenter suggested that the Treasury Department and the IRS provide an alternative attribution method based on year-over-year increases in the final benefit that an applicable individual is entitled to receive under the plan's benefit formula, without reducing that benefit to its present value. These final regulations generally adopt this suggestion, with minor modifications, and refer to the method as the formula benefit ratio method.

Under the formula benefit ratio method, remuneration provided to an applicable individual under a nonaccount balance plan is attributable to each taxable year in which the applicable individual provided services and for which there was an increase in the formula benefit. For these purposes, an applicable individual's formula benefit is the benefit that the applicable individual has a legally binding right to receive under the plan in the form that the remuneration being attributed has become otherwise deductible, which will generally be the form in which the remuneration is paid. If a portion of an applicable individual's benefit is paid or becomes otherwise deductible in one form (for example, a lump sum) and another portion of the benefit is paid or becomes otherwise deductible in another form (for example, a life annuity), the applicable individual has two separate formula benefits under the plan, and any increase in the formula benefit is determined separately for each portion of the benefit. If an amount becomes otherwise deductible under a plan but is not paid (for example, if an individual is in constructive receipt of an amount but does not receive payment of that amount), the form in which the benefit will be paid, if the actual form of payment is known, must be used to determine the formula benefit, and, if the actual form of payment is unknown, the formula benefit may be determined using any form of benefit in which the amount may be paid under the plan. In that case, the amount would not be attributed again when it is ultimately paid because it does not become otherwise deductible in the year of actual payment.

Similar to the manner in which amounts are attributed to services provided in taxable years of a covered health insurance provider under the account balance ratio method and the present value ratio method, the amounts attributable under the formula benefit ratio method to each taxable year in which an applicable individual provides services and for which there was an increase in the formula benefit is equal to the amount that becomes otherwise deductible multiplied by a fraction. The numerator of the fraction is the increase in the formula benefit for the taxable year, and the denominator is the sum of all such increases during which the applicable individual was a service provider (which, in most cases, will equal the amount that has become otherwise deductible). Thus, each payment is attributed to taxable years based on the proportion of the increase in the formula benefit under the plan during the taxable year to the total formula benefit to which the applicable individual has a legally binding right when the payment is made.

The amount of the increase in the formula benefit for a taxable year is equal to the excess of the formula benefit to which the individual has a legally binding right under the plan as of the measurement date for that taxable year (generally in the actual form of payment) over the greatest formula benefit to which the applicable individual had a legally binding right under the plan as of any measurement date in any earlier taxable year (in that same form of payment). Special rules apply for purposes of determining whether an increase occurs, and the amount of any increase, in the taxable year in which a payment occurs.

D. *Equity-Based Remuneration*

The final regulations generally adopt the rules described in the proposed regulations for attributing remuneration resulting from equity-based compensation, which includes stock options, stock appreciation rights (SARs), restricted stock, and restricted stock units (RSUs), with certain modifications made in response to comments.

The proposed regulations provide that remuneration resulting from the exercise of stock options and SARs is attributable on a daily *pro rata* basis to services performed by an 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 option or SAR is exercised, excluding any days on which the applicable individual is not a service provider.

Commenters suggested that, for a stock option or SAR that is subject to a substantial risk of forfeiture, a covered health insurance provider should be permitted to attribute remuneration resulting from the exercise of the stock option or SAR on a daily *pro rata* basis over the period beginning on the date the stock option or SAR is granted and ending on either the date the stock option or SAR is exercised or the date the stock option or SAR is no longer subject to a substantial risk of forfeiture, in either case excluding any days the applicable individual is not a service provider. The commenters explained that permitting attribution over the vesting period would be simpler for some covered health insurance providers because this method is commonly used for other financial accounting and regulatory purposes. The final regulations adopt this suggestion. However, the final regulations also provide that the covered health insurance provider must choose one of the two permissible methods and use it consistently for all stock options or SARs that it issues, unless certain exceptions apply.

One commenter suggested that, instead of attributing equity-based remuneration on a daily *pro rata* basis over the period from the grant date to the date of exercise or the date of vesting, a covered health insurance provider should be permitted to attribute equity-based remuneration entirely to the taxable year in which the equity-based remuneration vests, is exercised, or is otherwise includible in income. Specifically, the commenter suggested that if equity-based remuneration vests in connection with a corporate transaction, a covered health insurance provider should be permitted to attribute pretransaction appreciation entirely to the year of vesting. The final regulations do not adopt this suggestion. Attributing equity-based remuneration with a multiple-year vesting period to a single taxable year would not result in a reasonable attribution of remuneration to the taxable years in which the services were performed to earn the remuneration, as required by section 162(m)(6)(A).

The final regulations reserve on attribution rules applicable to grants of equity-based remuneration in situations in which the remuneration is determined by reference to equity in an entity treated as a partnership for federal tax purposes or by reference to equity interests in an entity described in § 1.409A–1(b)(5)(iii) (for example a mutual company). However, until the Treasury Department and the IRS issue further guidance on the attribution of this type of remuneration, the rules applicable to stock options, SARs, restricted stock, and RSUs, as described in the final regulations, may be applied by analogy (subject to any applicable rule under the Code (including subchapter K of the Code) affecting the timing, availability or amount of any deduction).

E. *Involuntary Separation Pay*

The final regulations, like the proposed regulations, provide that involuntary separation pay is attributable to services performed by an applicable individual during the taxable year of a 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. For this purpose, involuntary separation pay is defined as remuneration to which an applicable individual has a right to payment solely as a result of an involuntary separation from service. If involuntary separation pay is attributed to services performed in multiple taxable years, each payment of involuntary separation pay must be attributed to the same taxable years in the same proportion that the total amount of separation pay is attributed to those taxable years.

F. *Substantial Risk of Forfeiture*

The final regulations, like the proposed regulations, provide a two-step process for attributing certain remuneration to taxable years of the covered health insurance provider if the remuneration is subject to a substantial risk of forfeiture for more than one taxable year of a covered health insurance provider. This two-step process applies to amounts that are attributable under the general rule providing that remuneration is attributable to services performed by an applicable individual in the taxable year in which an applicable individual obtains a legally binding right to the remuneration and under the rules for account balance and nonaccount balance plans. Under this two-step process, the remuneration that is subject to the substantial risk of forfeiture is first attributed to the taxable year or years of the covered health insurance provider under the attribution rules that otherwise apply. Then, that remuneration is reattributed on a daily *pro rata* basis over the period that it is subject to a substantial risk of forfeiture (in other words, reattributed evenly over the vesting period).

One commenter suggested that the final regulations make this two-step attribution method optional, rather than mandatory, and permit covered health insurance providers to choose whether to apply this two-step method on a plan-by-plan basis. The final regulations do not adopt this suggestion. Attributing remuneration evenly over the vesting period results in a more accurate matching of remuneration to the taxable years in which the services were performed to earn the remuneration and is consistent with the treatment of equity-based compensation that is subject to a substantial risk of forfeiture.

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

A. *In General*

The final regulations generally adopt the rules described in the proposed regulations for applying the $500,000 deduction limitation of section 162(m)(6). The deduction limitation applies to the aggregate AIR and DDR attributable to services performed by an applicable individual for a covered health insurance provider in a disqualified taxable year. Accordingly, if AIR, DDR, or a combination of AIR and DDR, 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. When the $500,000 deduction limit is applied to an amount of AIR attributable to services performed by an applicable individual in a disqualified taxable year, the deduction limit with respect to that applicable individual for that disqualified taxable year is reduced, but not below zero, by the amount of the AIR to which the deduction limit is applied. If the applicable individual also has an amount of DDR attributable to services performed in that disqualified taxable year that becomes otherwise deductible in a subsequent taxable year, the deduction limit, as reduced, is applied to that amount of DDR in the first taxable year in which that DDR becomes otherwise deductible. If the amount of the DDR that becomes otherwise deductible is less than the reduced deduction limit, then the full amount of the DDR is deductible in that taxable year. To the extent that the amount of the DDR exceeds the reduced deduction limit, the covered health insurance provider's deduction for the DDR is limited to the amount of the reduced deduction limit and the amount of the DDR that exceeds the deduction limit cannot be deducted in any taxable year.

B. *Application of Deduction Limitation to Payments*

The final regulations generally adopt rules described in the proposed regulations for applying the deduction limitation to payments of remuneration. Any payment to an applicable individual may include remuneration that is attributable to services performed by the applicable individual in one or more taxable years of a covered health insurance provider under the rules set out in the final regulations. For example, remuneration resulting from the vesting of restricted stock that is subject to a substantial risk of forfeiture for five full taxable years of a covered health insurance provider is attributable to services performed by the applicable individual in each of the five years during which the restricted stock was subject to a substantial risk of forfeiture. In that case, a separate deduction limit 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 is 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 AIR or DDR attributable to services performed in that disqualified taxable year that was previously deductible. The final regulations contain several examples to illustrate how these rules apply to services performed and compensation payments made over multiple taxable years.

VIII. *Corporate Transactions*

A. *In general*

A corporation or other person may become a covered health insurance provider as a result of certain transactions such as a merger, acquisition or disposition of assets or stock (or other equity interests), reorganization, consolidation, separation, or other transaction resulting in a change in the composition of an aggregated group (generally referred to in this preamble and the final regulations as a corporate transaction). For example, as a result of the aggregation rules, members of a controlled group of corporations that does not include a health insurance issuer 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.

B. *Transition period relief*

The final regulations, like the proposed regulations, provide a transition period to ease the administrative burden on a person that becomes a covered health insurance provider solely as a result of a corporate transaction. Specifically, the final 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 a covered health insurance provider for the taxable year in which the transaction occurs (referred to in this preamble and the final regulations as transition period relief). The person, however, is a covered health insurance provider for any subsequent taxable year if it is a covered health insurance provider for the taxable year under the generally applicable rules for determining whether a person is a covered health insurance provider. A person that is a covered health insurance provider immediately before a corporate transaction is not eligible for this transition period relief because the person does not become a covered health insurance provider solely as a result of the corporate transaction (but may be eligible for certain transition relief relating to the attribution method it is permitted to use for the taxable year in which the corporate transaction occurs).

One commenter 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 until the first taxable year beginning at least six months after the transaction. The commenter asserted that the additional time is necessary to provide for an adequate transition period. The final regulations do not adopt this suggestion. Section 162(m)(6)(C)(ii) treats the members of an aggregated group as a single employer. The statute does not specifically provide that a person must be treated as a covered health insurance provider for its entire taxable year if it is a member of an aggregated group that includes a health insurance issuer for only a portion of the year. Therefore, the Treasury Department and the IRS have concluded that providing transition relief for corporate transactions during the taxable year that the corporate transaction occurs is consistent with the statute. However, providing transition relief for a taxable year in which a person is a member of an aggregated group that includes a health insurance issuer for its entire taxable year would be inconsistent with the statute.

C. *Certain applicable individuals*

The 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, the proposed regulations provide that the transition period otherwise applicable to certain members of an aggregated group does not extend to remuneration provided to applicable individuals of a health insurance issuer that is a covered health insurance provider and that is not eligible for the transition period relief because it does not become a covered health insurance provider solely as a result of a corporate transaction.

The final regulations generally adopt this rule, but expand it to include applicable individuals of not only health insurance issuers, but also other employers that would have been covered health insurance providers in the taxable year that the corporate transaction occurs, without regard to the corporate transaction. For example, if a controlled group of corporations that are not covered health insurance providers acquires a health insurance issuer and its non-health insurance issuer subsidiary, both of which are covered health insurance providers before the corporate transaction, the deduction limitation under section 162(m)(6) applies to all remuneration provided to the applicable individuals of the health insurance issuer and the non-health insurance issuer subsidiary, even if the remuneration is provided by a member of the acquiring controlled group that is otherwise eligible for transition period relief during the year of the acquisition.

D. *Consistency rule relief*

As explained previously in this preamble, a covered health insurance provider and all members of its aggregated group that provide remuneration under an account balance plan, a nonaccount balance plan, or through stock options or SARs generally must use the same attribution method for each type of plan (that is, account balance plans, nonaccount balance plans, and stock options or SARs) for all taxable years. As a result of a corporate transaction, however, a covered health insurance provider that uses a particular attribution method for one or more of these types of plans may become a member of an aggregated group that has a member that uses a different attribution method. To maintain consistency within the aggregated group, one or more covered health insurance providers would need to change attribution methods.

As noted in the preamble to the proposed regulations, once remuneration provided to an applicable individual from a plan has been attributed to a taxable year under a particular method (for example, because a payment has been made to the applicable individual), it would be administratively difficult to change the attribution method for amounts that become deductible with respect to that applicable individual in future years and still provide a reasonably accurate attribution of remuneration from that plan to the taxable years in which the applicable individual performed the services to earn the remuneration. 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. However, recognizing that there may be valid business reasons for changing attribution methods, such as a merger or acquisition, change in compensation structure, or change in accounting method, the Treasury Department and the IRS requested comments on the standards that should apply to determine whether and when an attribution method may be changed, and how that change would apply if deductions for amounts provided under the plan or arrangement have already been taken.

Commenters generally asked for flexibility in applying the consistency rules after a corporate transaction. The final regulations generally adopt this suggestion and provide that, if a covered health insurance provider that uses an attribution method for a particular type of plan (that is, an account balance plan, a nonaccount balance plan, or a stock option or SAR) becomes a member of an aggregated group with one or more covered health insurance providers that used a different attribution method for that type of plan before the corporate transaction, the covered health insurance provider will not violate the otherwise applicable consistency rules for the taxable year in which the corporate transaction takes place if it continues to use the same attribution method for that type of plan that it used before the transaction, even if it is different from the attribution method used by other members of the aggregated group. Further, the final regulations provide that, in this situation, a member of the aggregated group may change its attribution method to be the same as the attribution method used by other members of its aggregated group, subject to limitations or modifications that the Treasury Department and the IRS may provide in future guidance published in the Internal Revenue Bulletin.

One commenter suggested that application of the consistency rules following a corporate transaction should not require a retroactive change in attribution methods. The commenter noted that changing attribution methods retroactively would be administratively difficult. The final regulations generally adopt this suggestion and provide that, if an attribution method has been used to attribute remuneration provided to an applicable individual under an account balance plan, a nonaccount balance plan, or a stock option or SAR before a corporate transaction, that same method must be used in all future taxable years to attribute any remuneration provided to the applicable individual under the same type of plan to the extent that the applicable individual had a legally binding right to the remuneration as of the date of the corporate transaction.

Because a covered health insurance provider does not need to use an attribution method for amounts that become deductible during a taxable year until it files its tax return for that taxable year, the Treasury Department and the IRS have concluded that the exceptions to the consistency rules described in this section of the preamble and the final regulations will provide covered health insurance providers adequate time to make any adjustments to their attribution methods necessary to comply with the otherwise applicable consistency rules.

E. *Application of the de minimis rule*

One commenter suggested that the final regulations clarify that if a person ceases to be a member of an aggregated group, the *de minimis* exception is applied taking into account only the revenues and premiums of the person for the period during which it was a member of the aggregated group. The final regulations adopt this suggestion.

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

The deduction limitation under section 162(m)(6) only applies to AIR attributable to services performed by an applicable individual in taxable years beginning after December 31, 2012 and to DDR attributable to services performed by an applicable individual in taxable years beginning after December 31, 2009. It does not apply to remuneration attributable to services performed in taxable years beginning before January 1, 2010.

The proposed regulations provide that for purposes of determining whether remuneration provided under an account balance plan is attributable to services performed in taxable years beginning before January 1, 2010, a covered health insurance provider is required to use the same attribution method that it otherwise uses to attribute remuneration to taxable years, except that any substantial risk of forfeiture is disregarded.

A commenter suggested that a covered health insurance provider be permitted to use any method that is permissible for purposes of attributing remuneration to taxable years for purposes of determining the amount of remuneration that is attributable to services performed before January 1, 2010, even if the method is different from the method it otherwise uses to attribute remuneration to taxable years. The final regulations provide that if a covered health insurance provider uses a method for attributing amounts that become deductible under an account balance plan or a nonaccount balance plan to taxable years beginning after December 31, 2009, it must use that same method consistently for attributing amounts to taxable years beginning before January 1, 2010, except that, if it uses the account balance ratio method to attribute remuneration under an account balance plan to taxable years beginning after December 31, 2009, it may use the principal additions method to attribute amounts to taxable years beginning before January 1, 2010. The final regulations require certain adjustments to account balances for purposes of applying the account balance ratio method if this is done.

For nonaccount balance plans, the proposed regulations provide that the amount attributable to services provided in taxable years beginning before January 1, 2010, 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. The proposed regulations further provide that, for any subsequent taxable year of the covered health insurance provider, this amount may increase to 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 required 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).

The final regulations provide that for purposes of determining whether remuneration provided under a nonaccount balance plan is attributable to services performed in taxable years beginning before January 1, 2010, a covered health insurance provider is required to use the attribution method that it otherwise uses to attribute remuneration to taxable years. Although the amounts attributable to services performed in taxable years beginning before January 1, 2010, are determined differently under the final regulations, the amounts attributable to services performed in taxable years beginning before January 1, 2010, under the formula benefit ratio method generally will be similar to the amounts attributable to those years under the proposed regulations. For equity-based remuneration, the final regulations generally follow the rules described in the proposed regulations and provide that any remuneration resulting from equity-based compensation granted in a taxable year beginning before January 1, 2010, is not subject to the deduction limitation, regardless of whether the equity-based remuneration is subject to a substantial risk of forfeiture during a taxable year beginning after December 31, 2009. 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.

One commenter suggested that the final regulations should clarify that the grandfathering rules apply to remuneration provided under all types of arrangements (not only remuneration from account balance plans, nonaccount balance plans, and equity-based remuneration) and that grandfathered amounts be determined based on the attribution rules generally applicable to the arrangement under which remuneration was provided. The final regulations adopt this suggestion.

XII. *Transition Rules for Certain DDR*

Section 162(m)(6) applies to DDR 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. The proposed regulations include transition rules under which the section 162(m)(6) deduction limitation applies to DDR attributable to services performed in taxable years 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 DDR is attributable and a post-2012 covered health insurance provider for the taxable year in which that DDR is otherwise deductible. The final regulations retain this transition rule.

XIII. *Effective/Applicability Date*

The final regulations are effective on September 23, 2014. The final regulations apply to taxable years beginning after September 23, 2014**.** In addition, taxpayers may rely on these final regulations for taxable years beginning on or before September 23, 2014**.**

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866, as supplemented by Executive Order 13563. 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.

Drafting Information

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

List of Subjects

26 CFR Part 1

Income Taxes, Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is 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 section sets forth rules regarding the deduction limitation under section 162(m)(6), which provides that a covered health insurance provider's deduction for applicable individual remuneration (AIR) and deferred deduction remuneration (DDR) attributable to services performed by an applicable individual in a disqualified taxable year is limited to $500,000. Paragraph (b) of this section sets forth definitions of the terms used in this section. Paragraph (c) of this section explains the general limitation on deductions under section 162(m)(6). Paragraph (d) of this section sets forth the methods that must be used to attribute AIR and DDR to services performed in one or more taxable years of a covered health insurance provider. Paragraph (e) of this section sets forth rules on how the deduction limit applies to AIR and DDR 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 this section as remuneration that is otherwise deductible). Paragraph (f) of this section sets forth additional rules for persons participating in certain corporate transactions. Paragraph (g) of this section explains the interaction of section 162(m)(6) with sections 162(m)(1) and 280G. Paragraph (h) of this section sets forth rules for determining the amounts of remuneration that are not subject to the deduction limitation under section 162(m)(6) due to the statutory effective date (referred to in this section as grandfathered amounts). Paragraph (i) of this section sets forth transition rules for DDR that is attributable to services performed in taxable years beginning after December 31, 2009 and before January 1, 2013. Paragraph (j) of this section sets forth 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 § 1.414(c)–2(c) and (d) (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*—

(A) *In general*. 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 aggregated group to act as the parent entity.

(B) *Successor parent entities*. If a health insurance issuer that is the parent entity of an aggregated group pursuant to paragraph (b)(3)(ii)(A) of this section (a predecessor parent entity) ceases to be a member of the aggregated group (for example, as a result of a corporate transaction) and, after the predecessor parent entity ceases to be a member of the aggregated group, two or more health insurance issuers are members of the aggregated group, the new parent entity (the successor parent entity) is another member of the aggregated group designated in writing by the remaining members of the aggregated group. The successor parent entity must be a health insurance issuer in the aggregated group that has the same taxable year as the predecessor parent entity; provided, however, that if no health insurance issuer in the aggregated group has the same taxable year as the predecessor parent entity, the members of the aggregated group may designate in writing any other health insurance issuer in the aggregated group to be the parent entity.

(C) *Failure to designate a parent entity*. If the members of an aggregated group that includes two or more health insurance issuers and that is an affiliated service group (within the meaning of section 414(m)) or a group described in section 414(o) fail to designate in writing a health insurance issuer to act as the parent entity of the aggregated group, the parent entity of the aggregated group for all taxable years is deemed to be an entity with a taxable year that is the calendar year (without regard to whether the aggregated group includes or has ever included 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, 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)),

(B) 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)),

(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; however, if the parent entity of an aggregated group is a health insurance issuer described in paragraphs (b)(4)(i)(A) or (B) of this section, that health insurance issuer is a covered health insurance provider for any taxable year that it is otherwise a covered health insurance provider, without regard to whether the taxable year of any other health insurance issuer described in paragraphs (b)(4)(i)(A) or (B) of this section ends with or within its taxable year, 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) *Parent entities with short taxable years*. If for any reason a parent entity has a taxable year that is less than 12 months (for example, because the taxable year of a predecessor parent entity ends when it ceases to be a member of an aggregated group), then, for purposes of determining whether the parent entity and each other member of the aggregated group is a covered health insurance provider with respect to the parent entity's short taxable year (that is, for purposes of determining whether the taxable year of a health insurance issuer described in paragraph (b)(4)(i)(A) or (B) of this section ends with or within the short taxable year of the parent entity and for purposes of determining whether another member of the aggregated group has a taxable year ending with or within the short taxable year of the parent entity), the taxable year of the parent entity is treated as the 12-month period ending on the last day of the short taxable year. Accordingly, a parent entity is a covered health insurance provider for its short taxable year if it is a health insurance issuer described in paragraph (b)(4)(i)(A) or (B) of this section or if the taxable year of a health insurance issuer described in paragraph (b)(4)(i)(A) or (B) of this section in an aggregated group with the parent entity ends with or within the 12-month period ending on the last day of the parent entity's short taxable year. Similarly, each other member of the parent entity's aggregated group is a covered health insurance provider for its taxable year ending with or within the 12-month period ending on the last day of the parent entity's short taxable year.

(iii) *Predecessor and successor parent entities*. If the parent entity of an aggregated group changes, the members of the aggregated group may be covered health insurance providers based on their relationship to either or both parent entities with respect to the taxable years of the parent entities in which the change occurs.

(iv) *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).

(v) *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), (ii), or (iii) of this section for a taxable year beginning after December 31, 2012 is not a covered health insurance provider under 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)) 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 that taxable year. 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), (ii), or (iii) of this section for a taxable year beginning after December 31, 2009 and before January 1, 2013 is not 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 that taxable year. In determining whether premiums constitute less than two percent of gross revenues, the amount of gross revenues must be determined in accordance with generally accepted accounting principles. For the definition of the term *premiums*, see paragraph (b)(5) of this section. A person that would be a covered health insurance provider for a taxable year in an aggregated group with a predecessor parent entity and that would also be a covered health insurance provider for that taxable year in an aggregated group with a successor parent entity is not a covered health insurance provider under the *de minimis* exception only if the aggregated groups of which the person is a member meet the requirements of the *de minimis* exception based on both the taxable year of the predecessor parent entity and the taxable year of the successor parent entity.

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

(vi) *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)(A) 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 covered health insurance providers under 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)(v)(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)(A) 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) But for 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 a covered health insurance provider under paragraph (b)(4)(i)(A) 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 covered health insurance providers under paragraph (b)(4)(i) of this section ($3x is less than $3.26x (two percent of $163x)). Therefore, the *de minimis* exception of paragraph (b)(4)(v)(A) of this section applies, and V, W, and X are not 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 December 31, 2016. In addition, the members of the VWX aggregated group were not 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)(v)(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 $3.28x (two percent of $164x)), they were not covered health insurance providers for their immediately preceding taxable years solely because of the *de minimis* exception of paragraph (b)(4)(v)(A) of this section. Therefore, V, W, and X are not covered health insurance providers for their taxable years ending on December 31, 2016, June 30, 2017, and September 30, 2016, respectively, because of the one-year transition period under paragraph (b)(4)(v)(B) of this section. However, the members of the VWX 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.

Example 4. (i) Corporations W, X, Y, and Z are members of a controlled group described in section 414(b)) that is an aggregated group under paragraph (b)(2) of this section. W and X are health insurance issuers. Y and Z are not health insurance issuers. W is the parent entity of the aggregated group. W's and Y's taxable years end on December 31; X's taxable year ends on March 31; and Z's taxable year ends on June 30. As a result of a corporate transaction, W is no longer a member of the WXYZ aggregated group as of September 30, 2016, and W's taxable year ends on that date. Following the corporate transaction, X becomes the parent entity of the XYZ aggregated group.

(ii) Because W's taxable year is treated as the 12-month period ending on September 30, 2016, W is the parent entity for X's taxable year ending March 31, 2016, Z's taxable year ending June 30, 2016, and Y's taxable year ending December 31, 2015. Because X's taxable year begins on April 1, 2016 and ends on March 31, 2017, for purposes of paragraph (b)(4) of this section, X is the parent entity for Z's taxable year ending June 30, 2016, Y's taxable year ending December 31, 2016, and W's taxable year ending September 30, 2016.

Example 5. (i) The facts are the same as *Example 4*. In addition, W receives \$4x of premiums for providing minimum essential coverage and no other revenue for its taxable year beginning January 1, 2016 and ending September 30, 2016. X receives \$2x of premiums for providing minimum essential coverage and has no other revenue for its taxable year ending March 31, 2016. X receives \$1x of premiums for providing minimum essential coverage and no other revenue for its taxable year ending March 31, 2017. For its taxable year ending December 31, 2015, Y has \$100x in gross revenue. For its taxable year ending December 31, 2016, Y has \$200x in gross revenue. For its taxable year ending June 30, 2016, Z has \$120x in gross revenue (none of which constitute premiums for providing health insurance coverage that constitutes minimum essential coverage (as defined in section 5000A(f)). W, X, Y, and Z did not qualify for the *de minimis* exception in any prior taxable years.

(ii) For its taxable year ending June 30, 2016, Z does not meet the requirements for the *de minimis* exception described in paragraph (b)(4)(v)(A). Even though Z meets the requirements for the *de minimis* exception with respect to the taxable year of parent entity X ending March 31, 2017 (\$5x is less than two percent of \$325x), Z does not meet the requirements for the *de minimis* exception based on the premiums and gross revenues of the taxable years of its aggregated group members ending with or within the deemed 12-month taxable year of parent entity W ending September 30, 2016 (\$6x is more than two percent of \$226x). Therefore, Z is a covered health insurance provider for its June 30, 2016 taxable year.

(iii) For its taxable year ending December 31, 2015, Y does not meet the requirements for the *de minimis* exception described in paragraph (b)(4)(v)(A) (\$6x is more than two percent of \$226x). For its taxable year ending December 31, 2016, Y meets the requirements for the *de minimis* exception described in paragraph (b)(4)(v)(A) (\$5x is less than two percent of \$325x). Therefore, Y is a covered health insurance provider for its December 31, 2015 taxable year, but is not a covered health insurance provider for its December 31, 2016 taxable year.

(iv) For its taxable year ending September 30, 2016, W does not meet the requirements for the *de minimis* exception described in paragraph (b)(4)(v)(A). Even though W meets the requirements for the *de minimis* exception with respect to X's taxable year ending March 31, 2017 (\$5x is less than two percent of \$325x), W does not meet the requirements for the *de minimis* exception with respect its taxable year ending September 30, 2016 (\$6x is more than two percent of \$226x). Therefore, W is a covered health insurance provider for its September 30, 2016 taxable year.

(v) For its taxable year ending March 31, 2016, X does not meet the requirements for the *de minimis* exception (\$6x is more than two percent of \$226x). For its taxable year ending March, 31 2017, X meets the requirements for the *de minimis* exception (\$5x is less than two percent of \$325x). Therefore, X is a covered health insurance provider for its March 31, 2016 taxable year, but is not a covered health insurance provider for its March 31, 2017 taxable year.

(5) *Premiums*—(i) For purposes of this section, the term *premiums* means premiums written (including premiums written for assumption reinsurance, but reduced by assumption reinsurance ceded (as described in paragraph (b)(5)(ii) of this section), excluding indemnity reinsurance written (as described in paragraph (b)(5)(iii) of this section) and direct service payments (as described in paragraph (b)(5)(iv) of this section), but without reduction for ceding commissions or medical loss ratio rebates, determined in a manner consistent with the requirements for reporting under the Supplemental Health Care Exhibit published by the National Association of Insurance Commissioners or the MLR Annual Reporting Form filed with the Center for Medicare & Medicaid Services' Center for Consumer Information and Insurance Oversight of the U.S. Department of Health and Human Services (or any successor or replacement exhibits or forms).

(ii) *Assumption reinsurance*. For purposes of this paragraph (b)(5), the term *assumption reinsurance* means reinsurance for which there is a novation and the reinsurer takes over the entire risk of loss pursuant to a new contract.

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

(iv) *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 (or any other person described in guidance of general applicability published in the Internal Revenue Bulletin)—

(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 performed by an independent contractor for a covered health insurance provider is subject to the deduction limitation under section 162(m)(6). However, an independent contractor is not 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 the term *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 or AIR*. For purposes of this section, the term *applicable individual remuneration* or *AIR* 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). AIR does not include any DDR with respect to services performed during any taxable year. AIR 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 AIR for the disqualified taxable year in which the bonus is granted and paid. 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 AIR for the disqualified taxable year of the covered health insurance provider in which the grant of the restricted stock is made. See paragraph (b)(9)(ii) of this section for certain remuneration that is not treated as AIR for purposes of this section.

(11) *Deferred Deduction Remuneration or DDR*. For purposes of this section, the term *deferred deduction remuneration* or *DDR* means remuneration that would be AIR 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 DDR 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 AIR for the initial taxable year (and not DDR) 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 DDR attributable to services performed in taxable years beginning before January 1, 2013), DDR 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, DDR 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 DDR is otherwise deductible. However, remuneration that is attributable to services performed in a taxable year that is not a disqualified taxable year is not DDR even if the remuneration is otherwise deductible in a disqualified taxable year. See also paragraph (b)(9)(ii) of this section for certain remuneration that is not treated as DDR 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).

(13) *In-service payment*. An *in-service payment* is any amount that is paid with respect to an applicable individual from an account balance plan described in § 1.409A–1(c)(2)(i)(A) or (B) or a nonaccount balance plan described in § 1.409A–1(c)(2)(i)(C) in a taxable year of a covered health insurance provider during which at any time the applicable individual is a service provider (including amounts that became otherwise deductible, but were not paid, in a previous taxable year of a covered health insurance provider). Amounts that are paid in the last year that an applicable individual is a service provider (for example, amounts paid at separation from service) are in-service payments if the applicable individual is a service provider at any time during the

taxable year of the covered health insurance provider in which the payment is made.

(14) *Payment year*. For purposes of this section, the term *payment year* means the taxable year of a covered health insurance provider for which remuneration becomes otherwise deductible.

(15) *Measurement date*. For purposes of this section, the term *measurement date* means the last day of the taxable year of a covered health insurance provider.

(c) *Deduction Limitation*—(1) *AIR*. For any disqualified taxable year beginning after December 31, 2012, no deduction is allowed under this chapter for AIR 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) *DDR*. For any taxable year beginning after December 31, 2012, no deduction is allowed under this chapter for DDR 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 AIR for that applicable individual for that disqualified taxable year; and

(ii) the portion of the DDR for those services that was subject to the deduction limitation under section 162(m)(6)(A)(ii) and this paragraph (c)(2) in a preceding taxable year, or would have been subject to the deduction limitation 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 AIR and DDR attributable to services performed by an applicable individual in a disqualified taxable year of a covered health insurance provider. When an amount of AIR or DDR 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) *Overview*. Paragraphs (d)(1)(iii) through (d)(1)(v) of this section, and paragraph (d)(2) of this section, set forth rules of general applicability for attributing remuneration to services performed by an applicable individual in a taxable year of a covered health insurance provider. Paragraph (d)(3) sets forth two methods for attributing remuneration provided under an account balance plan—the account balance ratio method (described in paragraph (d)(3)(ii) of this section) and the principal additions method (described in paragraph (d)(3)(iii) of this section). Paragraph (d)(4) of this section sets forth two methods for attributing remuneration provided under a nonaccount balance plan—the present value ratio method (described in paragraph (d)(4)(ii) of this section) and the formula benefit ratio method (described in paragraph (d)(4)(iii) of this section). Paragraph (d)(5) of this section sets forth rules for attributing remuneration resulting from equity-based remuneration (such as stock options, stock appreciation rights, restricted stock, and restricted stock units). Paragraph (d)(6) of this section sets forth rules for attributing remuneration that is involuntary separation pay. Paragraph (d)(7) of this section sets forth rules for attributing remuneration that is received under a reimbursement arrangement, and paragraph (d)(8) of this section sets forth rules for attributing remuneration that results from a split-dollar life insurance arrangement.

(iii) *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 the commencement of services or a legally binding right arises*. To the extent that remuneration would otherwise be attributable in accordance with paragraphs (d)(2) through (d)(11) of this section to a taxable year ending before the later of the date an applicable individual begins providing services to a 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, the remuneration is attributed to services performed in the taxable year in which the later of these dates occurs. For example, if an applicable 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.

(iv) *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 treat any 12-month period as having 365 days (and so may ignore the extra day in leap years).

(v) *Remuneration subject to nonlapse restriction or similar formula*. For purposes of this section, if stock or other property 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 property, 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 in taxable years and the attribution of that remuneration to taxable years.

(2) *Legally binding right*. Unless attributable to services performed in a different taxable year pursuant to paragraphs (d)(3) through (d)(11) of this section, 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 a 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, an 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) *In general*. When remuneration for services performed by an applicable individual for a covered health insurance provider becomes otherwise deductible (for example, because the amount was paid or made available during that taxable year) from a plan described in § 1.409A–1(c)(2)(i)(A) or (B) (an *account balance plan*), that remuneration must be attributed to services performed by the applicable individual in a taxable year of the covered health insurance provider in accordance with an attribution method described in either paragraph (d)(3)(ii) or (d)(3)(iii) of this section. However, except as provided in paragraphs (d)(3)(ii)(D) and (f)(3) of this section, the covered health insurance provider and all members of its aggregated group must apply the same attribution method under this paragraph (d)(3) consistently for all taxable years beginning after September 23, 2014 for all amounts that become otherwise deductible under all account balance plans.

(ii) *Account balance ratio method*—(A) *In general*. Under this method, remuneration for services performed by an applicable individual for a covered health insurance provider that becomes otherwise deductible under an account balance plan must be attributed to services performed by the applicable individual in each taxable year of the covered health insurance provider ending with or before the payment year during which the applicable individual was a service provider and for which the account balance of the applicable individual increased (determined in accordance with paragraph (d)(3)(ii)(B) and (C) of this section). The amount attributed to each such taxable year is equal to the amount of remuneration that becomes otherwise deductible multiplied by a fraction, the numerator of which is the increase in the applicable individual's account balance under the plan for the taxable year, and the denominator of which is the sum of all such increases for all taxable years during which the applicable individual was a service provider. Thus, remuneration that becomes otherwise deductible under a plan is attributed to a taxable year of the covered health insurance provider in proportion to the increase in the applicable individual's account balance for that taxable year.

(B) *Increase in the account balance*. For purposes of this paragraph (d)(3)(ii), an increase in an account balance under an account balance plan occurs for a taxable year if the account balance as of the measurement date in that taxable year is greater than the account balance as of the measurement date in every earlier taxable year. In that case, the amount of the increase for that taxable year is equal to the excess of the applicable individual's account balance as of the measurement date for that taxable year over the greatest of the applicable individual's account balances under the plan as of the measurement date in every earlier taxable year. If the applicable individual's account balance as of the measurement date in a taxable year is less than or equal to the applicable individual's account balance as of the measurement date in any earlier taxable year, there is no increase in the account balance for that later taxable year.

(C) *Certain account balance adjustments*. For purposes of determining the account balance on a measurement date under paragraph (d)(3)(ii)(B) of this section, the account balance is adjusted as provided in this paragraph (d)(3)(ii)(C).

(*1*) *In-service payments*. If an in-service payment is made from the account of an applicable individual under an account balance plan in any taxable year of a covered health insurance provider, then the rules of this paragraph (d)(3)(ii)(C)(*1*) apply.

(*i*) Solely for purposes of determining the increase in the applicable individual's account balance as of the measurement date in the payment year (and not for purposes of attributing any amount that becomes otherwise deductible in any later taxable year), the account balance as of the measurement date for that taxable year is increased by the amount of all in-service payments made from the plan during that taxable year.

(*ii*) For purposes of attributing any amount that becomes otherwise deductible under the plan in any taxable year after the payment year of the in-service payment —

(*A*) the account balance as of the measurement date in each taxable year that ends before the taxable year to which the in-service payment is attributed pursuant to this paragraph (d)(3)(ii) is reduced by the sum of the amount of the in-service payment that is attributed to that taxable year and the amount of the in-service payment that is attributed to each taxable year that ends before that taxable year, if any, and

(B) to the extent that the in-service payment includes an amount that was deductible by the covered health insurance provider in a previous taxable year and, therefore, was previously attributable to services performed by the applicable individual in one or more taxable years of the covered health insurance provider (for example, because the amount was made available in a previous taxable year but was not paid at that time), the account balance as of the measurement date for each taxable year that ends before the taxable year to which the in-service payment is attributed pursuant to this paragraph (d)(3)(ii) is reduced by the sum of the amount of the in-service payment previously attributable to that taxable year and the amount of the in-service payment previously attributable to each taxable year that ends before that taxable year, if any.

(*2*) *Certain increases after ceasing to be a service provider*. Any addition (other than income or earnings) to an account balance plan made in a taxable year that begins after an applicable individual ceases to be a service provider (and that ends before the applicable individual becomes a service provider again, if applicable) is added to the account balance of the applicable individual as of the measurement date of the first preceding taxable year in which the applicable individual was a service provider.

(*3*) *Account balance adjustments for grandfathered amounts*. If a covered health insurance provider uses the principal additions method for determining grandfathered amounts for an applicable individual under paragraph (h) of this section, then, for purposes of determining the increase in the applicable individual's account balance, the account balance as of any measurement date is reduced by the amount of any grandfathered amounts otherwise included in the account balance.

(D) *Transition rule for amounts attributed before the applicability date of the final regulations.* Amounts that become otherwise deductible in taxable years beginning before September 23, 2014 may be attributed to services performed in taxable years of a covered health insurance provider under the rules set forth in the proposed regulations. If a covered health insurance provider attributes an amount paid to an applicable individual pursuant to a method permitted under the proposed regulations and then chooses to use the account balance ratio method to attribute amounts that subsequently become otherwise deductible with respect to that applicable individual, then, for purposes of applying the account balance ratio method to attribute any amount that becomes otherwise deductible under the plan after the taxable year in which the last payment was made that was attributed pursuant to the proposed regulations, the account balance as of the measurement date for each taxable year that ends before the taxable year in which the last payment that was attributed pursuant to the proposed regulations is reduced by the sum of the amount previously attributed to that taxable year under the proposed regulations and the amount previously attributable to each taxable year that ends prior to that taxable year under the proposed regulations, if any.

(iii) *Principal additions method*—(A) *In general*. Under this method, remuneration that becomes otherwise deductible under an account balance plan during a payment year must be attributed to services performed by the applicable individual in the taxable year of the covered health insurance provider during which the applicable individual was a service provider and in which the principal addition to which the amount relates is credited under the plan (determined in accordance with paragraph (d)(3)(iii)(B) and (C) of this section). An amount relates to a principal addition if the amount is a payment of the principal addition or earnings on the principal addition, based on a separate accounting of these amounts. The principal additions method described in this paragraph may be used to attribute amounts that become otherwise deductible under an account balance plan only if the covered health insurance provider separately accounts for each principal addition to the plan (and any earnings thereon) and traces each amount that becomes otherwise deductible under the plan to a principal addition made in a taxable year of the covered health insurance provider.

(B) *Principal addition*—(*1*) For purposes of this paragraph (d)(3)(iii), the excess (if any) of the sum of the account balance of an applicable individual in an account balance plan as of the last day of a taxable year and 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)(iii)(C) of this section), is treated as a principal addition that is credited to the plan in that taxable year if the applicable individual was a service provider during that taxable year. If the applicable individual was not a service provider during that taxable year, the excess described in the preceding sentence is treated as a principal addition that is credited to the plan in accordance with paragraph (d)(3)(iii)(B)(*2*) of this section.

(*2*) *Principal additions after termination of employment*. Any principal addition to an account balance plan made in a taxable year that begins after an applicable individual ceases to be a service provider (and that ends before the applicable individual becomes a service provider again, if applicable) is treated as a principal addition that is credited in the first preceding taxable year in which the applicable individual was a service provider.

(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, earnings on an amount deferred generally include an amount credited on behalf of an 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 rate of return that reflects a reasonable rate of interest (as defined in § 31.3121(v)(2)–1(d)(2)(i)(C)). For purposes of this paragraph (d)(3)(iii), the use of a rate of return that is not based on a predetermined actual investment or a reasonable rate of interest generally will result in the treatment of some or all of the remuneration as a principal addition that is attributable to services performed by an applicable individual in a taxable year of a covered health insurance provider in accordance with this paragraph (d)(3)(iii) of this section.

(4) *Nonaccount balance plans*—(i) *In general*. When remuneration for services performed by an applicable individual for a covered health insurance provider becomes otherwise deductible under a plan described in § 1.409A–1(c)(2)(i)(C) (a nonaccount balance plan), that remuneration must be attributed to services performed by the applicable individual in a taxable year of the covered health insur-

ance provider in accordance with the attribution method described in either paragraph (d)(4)(ii) or (d)(4)(iii) of this section. However, except as provided in paragraphs (d)(4)(ii)(D) and (d)(4)(iii)(D) and (f)(3) of this section, the covered health insurance provider and all members of its aggregated group must apply the same attribution method under this paragraph (d)(4) consistently for all taxable years beginning after September 23, 2014 for all amounts that become deductible under all nonaccount balance plans.

(ii) *Present value ratio attribution method*—(A) *In general*. Under this method, remuneration for services performed by an applicable individual for a covered health insurance provider that becomes otherwise deductible under a nonaccount balance plan must be attributed to services performed by the applicable individual in each taxable year of the covered health insurance provider ending with or before the payment year during which the applicable individual was a service provider for which the present value of the future payment(s) to be made to or on behalf of the applicable individual under the plan increased (determined in accordance with paragraph (d)(3)(ii)(B) and (C) of this section). The amount attributed to each such taxable year is equal to the amount of remuneration that becomes otherwise deductible under the plan multiplied by a fraction, the numerator of which is the increase in the present value of the future payment(s) to which the applicable individual has a legally binding right under the plan for the taxable year, and the denominator of which is the sum of all such increases for all taxable years during which the applicable individual was a service provider. Thus, remuneration that becomes otherwise deductible under a plan is attributed to a taxable year of the covered health insurance provider in proportion to the increase in the present value of the future payment(s) under the plan for that taxable year.

(B) *Increase in present value of future payments*. For purposes of this paragraph (d)(4)(ii), for a taxable year of a covered health insurance provider, an increase in the present value of the future payment(s) to which an applicable individual has a legally binding right under a nonaccount balance plan occurs if the present value of the future payment(s) as of the measurement date in the taxable year is greater than the present value of the future payment(s) as of the measurement date in every earlier taxable year. In that case, the amount of the increase for that taxable year is equal to the excess of the present value of the future payment(s) to which the applicable individual has a legally binding right under the plan as of the measurement date for that taxable year over the greatest present value of the future payment(s) to which the applicable individual had a legally binding right under the plan as of the measurement date in every earlier taxable year. If the present value of the future payment(s) as of a measurement date in a taxable year is less than or equal to the present value of the future payment(s) as of the measurement date in any earlier taxable year, then there is no increase in the present value of the future payment(s) to which the applicable individual has a legally binding right under the plan for that later taxable year. For purposes of determining the increase (or decrease) in the present value of a future payment(s) 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).

(C) *Certain present value adjustments*. For purposes of determining the present value of the future payment(s) to which an applicable individual has a legally binding right to receive as of a measurement date under paragraph (d)(4)(ii)(B) of this section, the present value is adjusted as provided in this paragraph (d)(3)(iii)(C).

(*1*) *In-service payments*. If an in-service payment is made to or on behalf of an applicable individual under a nonaccount balance plan in any taxable year of a covered health insurance provider, then the rules of this paragraph (d)(3)(iii)(C)(*1*) apply.

(*i*) Solely for purposes of determining the increase in the present value of the future payment(s) under the plan for the payment year (and not for purposes of attributing any amount that becomes otherwise deductible in any later taxable year), the present value of the future payment(s) under the plan as of the measurement date in the payment year is increased by the amount of any reduction in the present value of the future payment(s) resulting from the in-service payment made from the plan during that taxable year.

(*ii*) For purposes of attributing any amount that becomes otherwise deductible under the plan in any taxable year after the payment year of the in-service payment, the present value of the future payment(s) as of the measurement date for each taxable year that ends before the payment year is reduced by the present value of the future payment to which the applicable individual had a legally binding right to be paid on the date of the in-service payment (determined as of the measurement date based upon all of the applicable factors under the plan as of the measurement date, such as compensation and years of service on that date).

(*2*) *Increases in the present value of future payments after ceasing to be a service provider*. Any increase in the present value of the future payment(s) under a plan in a taxable year that begins after an applicable individual ceases to be a service provider (and that ends before the applicable individual becomes a service provider again, if applicable) that is not due merely to the passage of time or a change in the reasonable actuarial assumptions used to determine the present value of the future payment(s) is added to the present value of the future payment(s) for the applicable individual as of the measurement date of the most recent preceding taxable year in which the applicable individual was a service provider.

(D) *Transition rule for amounts attributed before the effective date of the final regulations*. Amounts that become otherwise deductible in taxable years beginning before September 23, 2014 may be attributed under the rules set forth in the proposed regulations. If a covered health insurance provider attributes an amount paid to an applicable individual pursuant to the proposed regulations and then chooses to use the present value ratio method to attribute amounts that subsequently become otherwise deductible with respect to that applicable individual, then, for purposes of applying the present value ratio method to attribute any amount that becomes otherwise deductible under the plan in any taxable year after the taxable year in which the last payment was made that was attributed pursuant to the proposed regulations, the present value of the future payment(s) as of the measurement date for each taxable year that ends before the taxable year in which the last payment that was attributed pursuant to the proposed regulations is reduced by the present value of each future payment to which the applicable individual had a legally binding right to be paid that was attributed pursuant to the proposed regulations (determined as of the measurement date based upon all of the applicable factors under the plan as of the measurement date, such as compensation and years of service on that date), with no adjustment for an amount that became otherwise deductible, but was not paid.

(iii) *Formula benefit ratio method*—(A) *In general*. Under this method, remuneration that becomes otherwise deductible under a nonaccount balance plan on a date (referred to for these purposes as the *date of payment*) must be attributed to services performed by the applicable individual in each taxable year of the covered health insurance provider ending with or before the payment year during which the applicable individual was a service provider and for which the formula benefit of the applicable individual under the plan increased (determined in accordance with paragraph (d)(3)(iii)(B), (C) and (D) of this section). The amount attributed to each such taxable year is equal to the amount of remuneration that becomes otherwise deductible under the plan on the date of payment multiplied by a fraction, the numerator of which is the increase in the applicable individual's formula benefit under the plan for the taxable year and the denominator of which is the sum of all such increases for all taxable years during which the applicable individual was a service provider (which will generally be the amount that becomes otherwise deductible under the plan on the date of payment). Thus, remuneration that becomes otherwise deductible under a plan is attributed to a taxable year of the covered health insurance provider in proportion to the increase in the applicable individual's formula benefit under the plan in that taxable year.

(B) *Formula benefit*. For purposes of this paragraph (d)(4)(iii), an applicable individual's formula benefit as of any date is the benefit (or portion thereof) to which the applicable individual has a legally binding right under a nonaccount balance plan as of that date determined based upon all of the applicable factors under the plan (for example, compensation and years of service as of that date), disregarding any substantial risk of forfeiture and assuming that the applicable individual meets any applicable eligibility requirements for the benefit as of that date. For this purpose, the formula benefit is expressed in the form that it has become otherwise deductible. For example, if an applicable individual's benefit under a plan is paid in the form of a single lump sum, then the applicable individual's formula benefit under the plan is expressed in the form of a single lump sum for all purposes under this paragraph (d)(4)(iii). If the amount that becomes otherwise deductible is payable in more than one form of payment (for example, 50 percent of the benefit is paid in the form of a lump sum and 50 percent is paid in the form of a life annuity), then each separate form of payment is treated as a separate formula benefit to which this paragraph (d)(4)(iii) is applied separately.

(C) *Increase in formula benefit*. For purposes of this paragraph (d)(4)(iii), an increase in an applicable individual's formula benefit under a nonaccount balance plan occurs for a taxable year of a covered health insurance provider if the formula benefit as of the measurement date in that taxable year is greater than the formula benefit as of the measurement date in every earlier taxable year. In that case, the amount of the increase for that taxable year is equal to excess of the formula benefit as of the measurement date in that taxable year over the greatest formula benefit as of any measurement date in any earlier taxable year. If the applicable individual's formula benefit as of a measurement date in a taxable year is less than or equal to the applicable individual's formula benefit as of the measurement date in any earlier taxable year, there is no increase in the formula benefit to which the applicable individual has a legally binding right under the plan for that later taxable year.

(D) *Certain adjustments*. For purposes of determining the increase in the formula benefit as of a date of payment under paragraph (d)(4)(iii)(C) of this section, the rules of this paragraph (d)(3)(iii)(D) apply—

(I) *Attribution to payment year*. Solely for purposes of attributing a payment under this paragraph (d)(4)(iii) (including an in-service payment), the date of payment is substituted for the measurement date in the payment year to determine whether an increase in the formula benefit occurs in the payment year and the amount of any such increase.

(II) *Amounts not paid*. If an amount becomes otherwise deductible under a nonaccount balance plan, but is not paid, the formula benefit for that amount must be determined using the form in which it will be paid, if that form is known, or any form in which it may be paid, if the actual form of payment is unknown.

(III) *Increases in the formula benefit after ceasing to be a service provider*. Any increase in the formula benefit with respect to an applicable individual resulting from a legally binding right arising in a taxable year that begins after the applicable individual ceases to be a service provider (and that ends before the applicable individual becomes a service provider again, if applicable) is added to the formula benefit with respect to the applicable individual as of the measurement date of the first preceding taxable year in which the applicable individual was a service provider. However, any increase in the formula benefit resulting from a legally binding right arising in a taxable year that begins before the applicable individual ceases to be a service provider is added to the formula benefit with respect to the applicable individual as of the measurement date of the taxable year in which the legally binding right arises, even if the increase is not reflected until after the applicable individual ceases to be a service provider (such as in the case of a cost of living adjustment).

(5) *Equity-based remuneration*—(i) *Stock options and stock appreciation rights*—(A) *In general*. Except as provided in paragraph (d)(5)(i)(B) of this section, remuneration resulting from the exercise of a stock option (including compensation income arising at the time of a disqualifying disposition of an incentive stock option described in section 422 or 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 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 option or SAR is exercised, excluding any days on which the applicable individual is not a service provider.

(B) *Stock options or SARs subject to a substantial risk of forfeiture*. If a stock option or SAR is subject to a substantial risk of forfeiture, a covered health insurance provider may attribute remuneration resulting from the exercise of the stock option or SAR to services performed by an applicable individual in a taxable year 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 first date that the stock option or SAR is no longer subject to a substantial risk of forfeiture, but only if the covered health insurance provider uses this attribution method consistently for all stock options or SARs exercised in taxable years of a covered health insurance provider beginning after September 23, 2014**,** except as provided in paragraph (f)(3) of this section.

(ii) *Restricted stock*. Remuneration resulting from restricted stock, for which an election under section 83(b) has not been made, that becomes substantially vested or transferred is attributed 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 restricted stock becomes substantially vested, or

(B) the date the restricted stock is transferred by the applicable individual.

(iii) *Restricted stock units*. Remuneration resulting from a restricted stock unit (*RSU*) is attributed on a daily pro rata basis to services performed by an applicable individual for a covered health insurance provider 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, excluding any days on which the applicable individual is not a service provider.

(iv) *Partnership interests and other equity*. [Reserved]

(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)). To the extent that involuntary separation pay is attributed to services performed in two or more taxable years of a covered health insurance provider as permitted under this paragraph, any amount of involuntary separation pay that is paid or made available must be attributed to services performed in all of those taxable years in the same proportion that the total involuntary separation pay is attributed to taxable years of the covered health insurance provider.

(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 a covered health insurance provider in which the applicable individual makes a payment for which the applicable individual has a right to reimbursement or receives an in-kind benefit, except that remuneration provided in the form of a reimbursement or in-kind benefit during a taxable year of a covered health insurance provider in which an applicable individual is not a service provider is attributable to services performed in the most recent 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 DDR within the meaning of paragraph (b)(11) of this section, although they may give rise to AIR. However, in certain situations, this type of arrangement may give rise to DDR for purposes of section 162(m)(6), for example, if amounts due 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, DDR 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. For purposes of these examples, the interest rates used in these examples are assumed to be reasonable.

Example 1 (Account balance plan – account balance ratio method with earnings and a single payment). (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. B's account earns five percent interest per year, compounded annually. Y credits $10,000 to B under the plan annually on January 1 for three years beginning on January 1, 2016. Thus, B's account balance is $10,500 ($10,000 + ($10,000 × 5%)) on December 31, 2016; $21,525 ($10,500 + $10,000 + ($20,500 × 5%)) on December 31, 2017; and $33,101 ($21,525 + $10,000 + ($31,525 × 5%)) on December 31, 2018. On January 1, 2019, Y pays B $33,101, the entire account balance. Y attributes payments under its account balance plans using the account balance ratio method described in paragraph (d)(3)(i) of this section.

(ii) The increase in B's account balance during 2016 is $10,500 ($10,500 – zero); the increase in B's account balance for 2017 is $11,025 ($21,525 − $10,500); and the increase in B's account balance for 2018 is $11,576 ($33,101 − $21,525). The sum of all the increases is $33,101 ($10,500 + $11,025 + $11,576). Accordingly, for Y's 2016 taxable year, the attribution fraction is .3172 ($10,500 / $33,101); for Y's 2017 taxable year, the attribution fraction is .3331 ($11,025 / $33,101); and for Y's 2018 taxable year, the attribution fraction is .3497 ($11,576 / $33,101).

(iii) With respect to the $33,301 payment made on January 1, 2019, $10,500 ($33,101 × .3172) of DDR is attributable to services performed by B in Y's 2016 taxable year; $11,026 ($33,101 × .3331) of DDR is attributable to services performed by B in Y's 2017 taxable year; and $11,575 ($33,101 × .3497) of DDR is attributable to services performed by B in Y's 2018 taxable year.

Example 2 (Account balance plan – principal additions method with earnings and a single payment. (i) The facts are the same as in *Example 1*, except that Y attributes remuneration using the principal additions method described in paragraph (d)(3)(ii) of this section.

(ii) The $10,000 principal addition made on January 1, 2016 and $1,576 of earnings thereon (interest on the 2016 $10,000 principal addition at five percent for three years compounded annually) are attributable to services performed by B in Y's 2016 taxable year; the principal addition of $10,000 on January 1, 2017 and $1,025 of earnings thereon (interest on the 2017 $10,000 principal addition at five percent for two years compounded annually) are attributable to services performed by B in Y's 2017 taxable year; and the principal addition of $10,000 to B's account on January 1, 2018 and $500 of earnings thereon (interest on the 2018 $10,000 principal addition at five percent for one year compounded annually) are attributable to services performed by B in Y's 2018 taxable year. Accordingly, with respect to the $33,301 payment made on January 1, 2019, $11,576 ($10,000 + $1,576) is attributable to services performed by B in Y's 2016 taxable year; $11,025 ($10,000 + $1,025) is attributable to services performed in Y's 2017 taxable year; and $10,500 ($10,000 + $500) is attributable to services performed by B in Y's 2018 taxable year.

Example 3 (Account balance plan – account balance ratio method with earnings and losses). (i) J is an applicable individual of corporation Z for all relevant taxable years. On January 1, 2016, J begins participating in a nonqualified deferred compensation plan of Z that is an account balance plan. Under the terms of the plan, all amounts are fully vested at all times, and Z will pay J's entire account balance on January 1, 2019. Z credits $10,000 to J under the plan on January 1, 2016 and January 1, 2018. Earnings under the terms of the plan are based on a predetermined actual investment (as defined in § 31.3121(v)(2)–1(e)(2)(i)(B)), which results in J'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, J's account balance is $10,500 ($10,000 + ($10,000 × 5%)); on December 31, 2017, J's account balance is $9,975 ($10,500 − ($10,500 × 5%)); and on December 31, 2018, J's account balance is $20,974 ($9,975 + $10,000 + ($19,975 × 5%)). On January 1, 2019, Z pays J the entire account balance of $20,974.

(ii) The increase in J's account balance for 2016 is $10,500 ($10,500 – zero); the increase in J's account balance for 2017 is zero (because J's account balance decreased by $525 ($9,975 − $10,500)); the increase in J's account balance for 2018 is $10,474 ($20,974 − $10,500, which is the highest account balance in any prior taxable year). The sum of all the increases is $20,974 ($10,500 + $10,474). Thus, for Z's 2016 taxable year the attribution fraction is .5006 ($10,500 / $20,974); for Z's 2017 taxable year the attribution fraction is zero because there was a decrease in the account balance for the year; and for Z's 2018 taxable year the attribution fraction is .4994 ($10,474 / $20,974).

(iii) Accordingly, with respect to the $20,974 payment made on January 1, 2019, $10,499 ($20,974 × .5006) of DDR is attributable to services performed by J in Z's 2016 taxable year, and $10,474 ($20,973.75 × .4994) of DDR is attributable to services performed by J in Z's 2018 taxable year. No amount is attributable to services performed by J in Z's 2017 taxable year because there was no increase in the account balance for that taxable year.

Example 4 (Account balance plan — principal additions method with earnings and losses). (i) The facts are the same as in *Example 3*, except that Z attributes remuneration using the principal additions method described in paragraph (d)(3)(ii) of this section.

(ii) The $10,000 principal addition made on January 1, 2016 and the $474 of net earnings thereon ($500 of earnings for 2016, $525 of losses for 2017, and $499 of earnings for 2018) are attributable to services performed by J in Z's 2016 taxable year; and the $10,000 principal addition made on January 1, 2018 and the $500 of earnings thereon are attributable to services performed by J in Z's 2018 taxable year. Accordingly, with respect to the $20,974 payment made on January 1, 2019, $10,474 ($10,000 + $474) of DDR is attributable to services performed by J in Z's 2016 taxable year, and $10,500 ($10,000 + $500) of DDR is attributable to services performed by J in Z's 2018 taxable year.

Example 5 (Account balance plan – account balance ratio method with losses and an in-service payment). (i) N is an applicable individual of corporation M for all relevant taxable years. On January 1, 2016, 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 are $110,000 on December 31, 2016; $90,000 on December 31, 2017; $250,000 on December 31, 2018; and $240,000 on December 31, 2019. N ceases providing services to N on December 31, 2019. In accordance with the plan terms, M pays to N $10,000 on September 30, 2017, $150,000 on January 1, 2021, and $100,000 on January 1, 2022. M attributes payments under its account balance plans using the account balance ratio method described in paragraph (d)(3)(i) of this section.

(ii) For purposes of attributing the $10,000 payment made on September 30, 2017 to taxable years, the increase in N's account balance for 2016 is $110,000 ($110,000 – zero). N's account balance for 2017 is treated as $100,000 ($90,000 + $10,000 payment on September 30, 2017), but, because the account balance of $100,000 is less than the account balance in an earlier year, the increase in N's account balance for 2017 is zero. The sum of all the increases in N's account balance is $110,000 ($110,000 + $0). Thus, the attribution fraction for 2016 is 1 ($110,000 / $110,000), and the attribution fraction for 2017 is zero ($0 / $110,000). Accordingly, with respect to the $10,000 payment made on September 30, 2017, the entire $10,000 is attributable to services performed by N in M's 2016 taxable year, and no amount is attributable to services performed by N in M's 2017 taxable year.

(iii) After attributing the September 30, 2017 payment of $10,000 to 2016, N's account balance for 2016 is treated as being $100,000 ($110,000 − $10,000), and the increase for 2016 is likewise treated as $100,000; N's account balance for 2017 decreased; the increase in N's account balance for 2018 is $150,000 ($250,000 − $100,000); and N's account balance for 2018 decreased. The sum of all the increases is $250,000 ($100,000 + $150,000). Thus, the attribution fraction for 2016 is .40 ($100,000 / $250,000); the attribution fraction for 2017 is zero ($0 / $250,000); the attribution fraction for 2018 is .60 ($150,000 / $250,000); and the attribution fraction for 2019 is zero ($0 / $250,000).

(iv) Accordingly, with respect to the $150,000 payment made on January 1, 2021, $60,000 ($150,000 × .40) is attributable to services performed by N in M's 2016 taxable year, and $90,000 ($150,000 × .60) is attributable to services performed by N in M's 2018 taxable year. With respect to the $100,000 payment made on January 1, 2022, $40,000 ($100,000 × .40) is attributable to services performed by N in M's 2016 taxable year, and $60,000 ($100,000 × .60) is attributable to services performed by N in M's 2018 taxable year. No amount is attributable to services performed by N in M's 2017 and 2019 taxable years.

Example 6 (Account balance plan – principal additions method with multiple payments). (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). L makes principal additions of $90,000 on June 30, 2016; $140,000 on June 30, 2017; and $180,000 on June 30, 2018. The predetermined actual investment earns five percent for 2016, seven percent for 2017; eight percent for 2018; and nine percent for 2019. Thus, as of December 31, 2018, the earnings with respect to the $90,000 principal addition made on June 30, 2016 are $16,605, for a total of $106,605; and the earnings with respect to the $140,000 principal addition made on June 30, 2017 are $16,492, for a total of $156,492. As of January 1, 2020, the earnings with respect to the $180,000 principal addition made on June 30, 2018 are $24,048, for a total of $204,048. Under the terms of the plan, the principal addition (and earnings thereon) made on June 30, 2016 and June 30, 2017 are payable on December 31, 2018, and the principal addition (and earnings thereon) made on June 30, 2018 is payable on January 1, 2020. On December 31, 2018, L pays O $263,097 in accordance with the plan terms. On January 1, 2020, L pays O the remaining account balance of $204,048 in accordance with the plan terms.

(ii) The $263,097 payment made on December 31, 2018 is attributed to services performed by O in the 2016 and 2017 taxable years. Of the $263,097 payment, $106,605 is attributable to services performed by O in L's 2016 taxable year because this amount represents the $90,000 principal addition made on June 30, 2016 and earnings thereon. The remaining $156,492 is attributable to services performed by O in L's 2017 taxable year because this amount represents the $140,000 principal addition made on June 30, 2017 and earnings thereon. The $204,048 payment made on January 1, 2020 is attributable to services performed by O in L's 2018 taxable year because this amount represents the $180,000 principal addition made on June 30, 2018 and earnings thereon.

Example 7 (Account balance plan – account balance ratio method with an employer contribution after the applicable individual ceases to be a service provider). (i) A is an applicable individual of corporation Z for all relevant taxable years. On January 1, 2016, A begins participating in a nonqualified deferred compensation plan of Z that is an account balance plan. Under the terms of the plan, all amounts are fully vested at all times. The balances in A's account (including employer contributions and earnings) are $20,000 on December 31, 2016, and $60,000 on December 31, 2017. On December 31, 2017, A ceases providing services to Z. On January 1, 2019, Z makes a discretionary contribution of $30,000 to A's account balance plan. On December 31, 2019, in accordance with the plan terms, Z pays $120,000 to A, which is N's entire account balance. Z attributes payments under its account balance plans using the account balance ratio method described in paragraph (d)(3)(i) of this section.

(ii) The increase in A's account balance for 2016 is $20,000; the increase in A's account balance for 2017 is $40,000. The discretionary contribution made on January 1, 2019 of $30,000 is added to the account balance for 2017. Thus, the discretionary contribution of $30,000 on January 1, 2019, is treated as increasing A's account balance for 2017 by $30,000. The increase in A's account balance for 2016 is $20,000, and the increase in A's account balance for 2017 is $70,000 ($40,000 + $30,000). The sum of all the increases is $90,000 ($20,000+$70,000).

(iii) Thus, the attribution fraction for 2016 is .2222 ($20,000 / $90,000); and the attribution fraction for 2017 is .7778 ($70,000 / $90,000). Accordingly, with respect to the $120,000 payment made on January 1, 2019, $26,664 ($120,000 × .2222) is attributable to services performed by A in Z's 2016 taxable year, and $93,336 ($120,000 × .7778) is attributable to services performed by A in Z's 2017 taxable year.

Example 8 (Account balance plan – principal additions method with a principal addition after the applicable individual ceases to be a service provider). (i) C is an applicable individual of corporation X for all relevant taxable years. On January 1, 2016, C begins participating in a nonqualified deferred compensation plan of X that is an account balance plan. Earnings under the terms of the plan are based on a predetermined actual investment (as defined in § 31.3121(v)(2)–1(e)(2)(i)(B)). Under the terms of the plan, all amounts are fully vested at all times. X credits a $10,000 principal addition to C under the plan on April 1, 2016, and a $20,000 principal addition to C on April 1, 2017. C ceases providing services to X on December 31, 2017. On January 1, 2019, X credits $30,000 to C's account in recognition of C's past services. The $10,000 principal addition made on April 1, 2016 increases to $15,000 as of December 31, 2019, as a result of earnings. The $20,000 principal addition made on April 1, 2017, increases to $28,000 as of December 31, 2019 as a result of earnings. The January 1, 2019, contribution of $30,000 increases to $33,000 as of December 31, 2019, as a result of earnings. On December 31, 2019, in accordance with the plan terms, X pays C's entire account balance of $76,000. X attributes payments under its account balance plans using the principal additions method described in paragraph (d)(3)(ii) of this section.

(ii) When the $76,000 payment is made to C on December 31, 2019, the remuneration becomes attributable to service performed by C in prior taxable years. The $10,000 principal addition in 2016 plus earnings thereon of $5,000 are attributable to services performed by C in X's 2016 taxable year, and the $20,000 principal addition in 2017 (plus earnings thereon of $8,000) are attributable to services performed by C in X's 2017 taxable year. The principal addition of $30,000 plus earnings thereon of $3,000 ($33,000) are also attributable to services performed by C in X's 2017 taxable year. Thus, $16,500 of the $33,000 is attributed to services performed by C in X's 2017 taxable year.

(iii) Accordingly, with respect to the $76,000 payment by X to C on December 31, 2019, $15,000 ($10,000 + $5,000) is attributed to services performed by C in X's 2016 taxable year, and $61,000 ($20,000 + $8,000 + $33,000) is attributed to services performed by C in X's 2017 taxable year.

Example 9 (Nonaccount balance plan – present value ratio method with a single payment). (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. C ceases providing services on December 31, 2019. The payment of $100,000 is made on January 1, 2020. X determines the present value of the payment using an interest rate of five percent for all years.

(ii) The present value of $100,000 payable on January 1, 2020, determined using a five percent interest rate, is $82,270 as of December 31, 2015; $86,384 as of December 31, 2016; $90,703 as of December 31, 2017; $95,238 as of December 31, 2018, and $100,000 as of December 31, 2019. Accordingly, $82,270 is the amount of the increase in the present value of the future payment of $100,000 for X's 2015 taxable year ($82,270 − $0); $4,114 ($86,384 − $82,270) is the increase in the present value of the future payment for X's 2016 taxable year; $4,319 ($90,703 − $86,384) is the increase in the present value of the future payment for X's 2017 taxable year; $4,535 ($95,238 − $90,703) is the increase in the present value of the future payment for X's 2018 taxable year; and $4,762 ($100,000 − $95,238) is the increase in the present value of the future payment for X's 2019 taxable year. The sum of all the increases is $100,000 ($82,270 + $4,114 + $4,319 + $4,535 + $4,762). Thus, the attribution fraction for 2015 is .8227 ($82,270 / $100,000); the attribution fraction for 2016 is .0411 ($4,114 / $100,000); the attribution fraction for 2017 is .0432 ($4,319 / $100,000); the attribution fraction for 2018 is .0454 ($4,535 / $100,000); and the attribution fraction for 2019 is .0476 ($4,762 / $100,000).

(iii) The $100,000 payment made on January 1, 2020 is multiplied by the attribution fraction for each taxable year, and the result is the amount that is attributable to service performed by C for that taxable year. Accordingly, $82,270 ($100,000 × .8227) is attributable to services performed by C in X's 2015 taxable year; $4,114 ($100,000 × .0411) is attributable to services performed by C in X's 2016 taxable year; $4,319 ($100,000 × .0432) is attributable to services performed by C in X's 2017 taxable year; $4,535 ($100,000 × .0454) is attributable to services performed by C in X's 2018 taxable year; and $4,762 ($100,000 × .0476) is attributable to services performed by C in X's 2019 taxable year.

Example 10. (Nonaccount balance plan – present value ratio method with an in-service payment). (i) The facts are the same as *Example 9*, except that X grants C a vested right to a $40,000 payment on June 30, 2018 and a vested right to a $60,000 payment on January 1, 2020.

(ii) The present value of the future payments ($40,000 payable on June 30, 2018 and $60,000 payable on January 1, 2020), determined using a five percent interest rate, is $84,758 as of December 31, 2015; $88,996 as of December 31, 2016; $93,446 as of December 31, 2017; and $57,143 as of December 31, 2018. However, for purposes of determining the increase in the present value of the future payments during 2018 (the year of the in-service payment), $57,143 must be increased by $40,000, the amount of the in-service payment, resulting in a present value of future payments as of December 31, 2018, of $97,143 solely for purposes of attributing the $40,000 in-service payment. Accordingly, $84,758 is the amount of the increase in the present value of the future payments for X's 2015 taxable year, $4,238 ($88,896 − $84,758) is the increase in the present value of the future payments for X's 2016 taxable year, $4,450 ($93,446 − $88,996) is the increase in the present value of the future payments for X's 2017 taxable year, and $3,697 ($97,143 − $93,446) is the increase in the present value of the future payments for X's 2018 taxable year. The sum of all the increases is $97,143 ($84,758 + $4,238 + $4,450 + $3,697). Thus, the attribution fraction for 2015 is .8725 ($84,758 / $97,143); the attribution fraction for 2016 is .0436 ($4,238 / $97,143); the attribution fraction for 2017 is .0458 ($4,450 / $97,143); and the attribution fraction for 2018 is .0381 ($3,697 / $97,143).

(iii) Accordingly, with respect to the $40,000 payment made on June 30, 2018, $34,900 ($40,000 × .8725) is attributable to services performed by C in X's 2015 taxable year; $1,744 ($40,000 × .0436) is attributable to services performed by C in X's 2016 taxable year; $1,832 ($40,000 x .0458) is attributable to services performed by C in X's 2017 taxable year; and $1,524 ($40,000 × .0381) is attributable to services performed by C in X's 2018 taxable year.

(iv) For purposes of attributing the $60,000 payment made on January 1, 2020, the present value of the future payments for each taxable year that ends prior to the taxable year in which the $40,000 in-service payment is paid is reduced by the present value of the future payment to which the applicable individual had a legally binding right to be paid on the date the $40,000 in-service is paid (based on the applicable factors and plan provisions as of the measurement date in each such taxable year). The present value of that future payment is $35,396 as of December 31, 2015; $37,166 as of December 31, 2016; and $39,024 as of December 31, 2017. Therefore, for purposes of attributing the $60,000 payment on January 1, 2020, the present value of future payments as of December 31, 2015, is $49,362 ($84,758 − $35,396); the present value of future payments as of December 31, 2016, is $51,830 ($88,996 − $37,166); the present value of future payments as of December 31, 2017, is $54,422 ($93,446 − $39,024). The present value of future payments as of December 31, 2018, is $57,143. Accordingly, $49,362 is the increase in the present value of the future payment of $60,000 for X's 2015 taxable year; $2,468 ($51,830 − $49,362) is the increase in the present value of the future payment for X's 2016 taxable year; $2,592 ($54,422 − $51,830) is the increase in the future value of the payment for X's 2017 taxable year; $2,721 ($57,143 − $54,422) is the increase in the future value of the payments for X's 2018 taxable year; and $2,857 ($60,000 − $57,143) is the increase in the future value of the payment for X's 2019 taxable year. The sum of all the increases is $60,000 ($49,362 + $2,468 + $2,592 + $2,721 +$2,857). Thus, the attribution fraction for 2015 is .8227 ($49,362 / $60,000); the attribution fraction for 2016 is .0411 ($2,468 / $60,000); the attribution fraction for 2017 is .0432 ($2,592 / $60,000); the attribution fraction for 2018 is .0454 ($2,721 / $60,000); and the attribution fraction for 2019 is .0476 ($2,857 / $60,000).

(v) Accordingly, with respect to the $60,000 payment made on January 1, 2020, $49,362 ($60,000 × .8227) is attributable to services performed by C in X's 2015 taxable year; $2,468 ($60,000 × .0411) is attributable to services performed by C in X's 2016 taxable year; $2,592($60,000 × .0432) is attributable to services performed by C in X's 2017 taxable year; $2,721 ($60,000 × .0454) is attributable to services performed by C in X's 2018 taxable year; and $2,857 ($60,000 × .0476) is attributable to services performed by C in X's 2019 taxable year.

Example 11 (Nonaccount balance plan – formula benefit ratio method with losses and multiple payments). (i) D is an applicable individual of W for all relevant taxable years. D becomes a participant in a nonaccount balance plan sponsored by R on January 1, 2018. The plan provides W with the vested right to receive a five annual installments each equal to $20,000 times the full years of service that D completes. The first payment is to be made on the later of December 31, 2027, or on the December 31 of the first year in which D is no longer a service provider. D has a break in service in 2020 and does not accrue an additional benefit during 2020. D ceases to be a service provider on December 31, 2022, after having completed four years of service, entitling D to five annual payments equal to $80,000 per year commencing on December 31, 2027. W determines the present value of amounts to be paid under the plan using an interest rate of five percent for 2018 and 2019, and seven percent for 2021, 2022, and 2023. W uses the formula benefit ratio method described in paragraph (d)(4)(ii) of this section.

(ii) Under the plan formula, in 2018, E accrued the right to a $20,000 annual payment for five years, and E accrued an additional $20,000 in annual payments in 2019, 2021, and 2022, resulting in the right to receive an annual payment of $80,000 commencing on December 31, 2027. Thus, the attribution fraction is .25 for 2018 ($20,000 / $80,000), .25 for 2019 ($20,000 / $80,000), .25 for 2021 ($20,000 / $80,000), and .25 for 2022 ($20,000 / $80,000). The attribution fraction for 2020 is zero because no additional formula benefit accrued during that year.

(iii) The attribution fraction for each disqualified taxable year is multiplied by each payment and the result is attributed to that taxable year. Accordingly, with respect to each $80,000 payment, $20,000 ($80,000 × .25) is attributable to services performed by D in W's 2018 taxable year; $20,000 ($80,000 × .25) is attributable to services performed by D in W's 2019 taxable year; $20,000 ($80,000 × .25) is attributable to services performed by D in W's 2021 taxable year; and $20,000 ($80,000 × .25) is attributable to services performed by D in W's 2022 taxable year. No amount is attributable to services performed by D in W's 2020 taxable year.

Example 12 (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). The stock option is not subject to a substantial risk of forfeiture. 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) × 100).

(ii) 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 × $10) of remuneration is attributed to services performed by E in each of V's 2016, 2017, 2019, and 2020 taxable years.

Example 13 (Stock option subject to a substantial risk of forfeiture). (i) The facts are the same as *Example 14*, except that the stock option is subject to a substantial risk of forfeiture that lapses on December 31, 2017, and is not transferable until that date, and V chooses to attribute remuneration resulting from the exercise of stock options that are subject to a substantial risk of forfeiture over the period beginning on the date of grant and ending on the date the substantial risk of forfeiture lapses, as permitted under paragraph (d)(5)(i)(B) of this section.

(ii) The $14,600 is attributed *pro rata* over the 730 days from January 1, 2016 to December 31, 2017 (365 days per year for the 2016 and 2017 taxable years), so that $20 ($14,600 divided by 730) is attributed to each calendar day in this period, and $7,300 (365 days × $20) is attributed to services performed by E in each of V's 2016 and 2017 taxable years.

Example 14 (Restricted stock). (i) F is an applicable individual of corporation U for all relevant taxable years. On January 1, 2017, U grants to F 1000 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 remuneration resulting from the vesting of the restricted stock is $109,500 ($109.50 × 1000).

(ii) The $109,500 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 $100 ($109,500 divided by 1,095) is attributed to each calendar day in this period, and remuneration of $36,500 (365 days × $100) is attributed to services performed by F in each of U's 2017, 2018, and 2019 taxable years.

Example 15 (RSUs). (i) G is an applicable individual of corporation T for all relevant taxable years. On January 1, 2018, T grants to G 1000 RSUs. Under the terms of the grant, T will pay G an amount on December 31, 2020 equal to the fair market value of 1000 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 $219,000 ($219 × 1000).

(ii) The $219,000 in remuneration is attributed to services performed by G 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 $200 ($219,000 / 1,095) is attributed to each calendar day in this period, and $73,000 (365 days × $200) is attributed to service performed by G in each of T's 2018, 2019, and 2020 taxable years.

Example 16 (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 legally binding 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, each $150,000 payment may be attributed on a daily *pro rata* basis to the period beginning on January 1, 2015 and ending December 31, 2016, so that $410.96 (($150,000 × 2) / (365 × 2)) is attributed to each day of S's 2015 and 2016 taxable years. Accordingly, $150,000 is attributed to services performed by H in each of S's 2015 and 2016 taxable years.

Example 17 (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) $100,000 is attributed to services performed in R's 2020 taxable year, the taxable year in which I ceases to be a service provider.

(10) *Certain remuneration subject to a substantial risk of forfeiture*. If remuneration is attributable in accordance with paragraphs (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), (d)(3), or (d)(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 begins on a day other than the first day of a covered health insurance provider's taxable year or 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.

(11) *Example*. The following example illustrates the principles of paragraph (d)(10) of this section. For purposes of this example, the corporation has a taxable year that is the calendar year and is a covered health insurance provider for all relevant taxable years, DDR 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 (Account balance plan subject to a substantial risk of forfeiture using the principal additions 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. Q attributes increases in account balances under the plan using the principal additions method described in paragraph (d)(3)(ii) of this section.

(ii) Earnings 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) Remuneration that is attributable to two or more taxable years of Q during which it is subject to a substantial risk of forfeiture must be reattributed on a daily *pro rata* basis to 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, $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. Thus, $12,165 is attributed to services performed by J in each of Q's 2016, 2017, and 2018 taxable years.

(e) *Application of the deduction limitation*–(1) *Application to aggregate amounts*. The $500,000 deduction limitation is applied to the aggregate amount of AIR and DDR attributable to services performed by an applicable individual in a disqualified taxable year. The aggregate amount of AIR and DDR attributable to services performed by an applicable individual in a disqualified taxable year that exceeds the $500,000 deduction limit is not allowed as a deduction in any taxable year. Therefore, for example, if an applicable individual has more than $500,000 of AIR attributable to services performed for a covered health insurance provider in a disqualified taxable year, the amount of that AIR that exceeds $500,000 is not deductible in any taxable year, and no DDR 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 AIR for a disqualified taxable year that is $500,000 or less and DDR attributable to services performed in the same disqualified taxable year that, when combined with the AIR for the year, exceeds $500,000, all of the AIR is deductible in that disqualified taxable year, but the amount of DDR attributable to that taxable year that is deductible in future taxable years is limited to an amount equal to $500,000 less the amount of the AIR for that taxable 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 AIR and DDR 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 limit 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 AIR attributable to services performed in a disqualified taxable year and is reduced (but not below zero) by the amount of the AIR to which the deduction limit is applied. If the applicable individual also has an amount of DDR attributable to services performed in that disqualified taxable year that becomes otherwise deductible in a subsequent taxable year, the deduction limit, as reduced, is applied to that amount of DDR in the first taxable in which the DDR becomes otherwise deductible. The deduction limit is then further reduced (but not below zero) by the amount of the DDR to which the deduction limit is applied. If the applicable individual has an additional amount of DDR attributable to services performed in the original disqualified taxable year that becomes otherwise deductible in a subsequent taxable year, the deduction limit, as further reduced, is applied to that amount of DDR in the taxable year in which it is otherwise deductible. This process continues for future taxable years in which DDR 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 AIR or DDR attributable to services performed by an applicable individual in a disqualified taxable year for the excess of those amounts over the deduction limit (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 remuneration may include amounts that are attributable to services performed by an applicable individual in one or more taxable years of a covered health insurance provider pursuant to paragraphs (d)(2) through (d)(11) 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 AIR and DDR attributable to services performed in that disqualified taxable year that was deductible in an earlier taxable year.

(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; DDR 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 DDR 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 AIR, and grants L a right to $50,000 of DDR 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 DDR 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 AIR for 2015. Because the $550,000 of AIR in 2015 is greater than the deduction limit, O may deduct only $500,000 of the AIR for 2015, and $50,000 of the $550,000 of AIR is not deductible for any taxable year. The deduction limit for remuneration attributable to services provided by L in O's 2015 taxable year is then reduced to zero. Because the $50,000 in DDR attributable to services performed by L in 2015 exceeds the reduced deduction limit of zero, that $50,000 is not deductible for any taxable year.

Example 2 (Installment payments of DDR 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 AIR, and grants M a right to $220,000 of DDR 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 ceases providing services on December 31, 2016. In 2020, N pays M $120,000 of DDR that is attributable to services performed in N's 2016 taxable year. In 2021, N pays M the remaining $100,000 of DDR 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 AIR for 2016. Because the deduction limit is greater than the AIR, N may deduct the entire $300,000 of AIR paid in 2016. The $500,000 deduction limit is then reduced to $200,000 because the limitation is reduced by the amount of AIR ($500,000 − $300,000). The reduced deduction limit is then applied to M's $120,000 of DDR attributable to services performed by M in N's 2016 taxable year that is paid in 2020. Because the reduced deduction limit of $200,000 is greater than the $120,000 of DDR, N may deduct the entire $120,000 of DDR paid in 2020. The $200,000 deduction limit is reduced to $80,000 by the $120,000 in DDR because the limit is reduced by the amount of DDR to which the deduction limit applied ($200,000 − $120,000). The reduced deduction limit of $80,000 is then applied to the remaining $100,000 payment of DDR attributable to services performed by M in N's 2016 taxable year. Because the $100,000 payment by N for 2021 exceeds the reduced deduction limit of $80,000, N may deduct only $80,000 of the payment 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 account balance ratio method). (i) N is an applicable individual of corporation M for all relevant taxable years. On January 1, 2015, 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 earnings) are $50,000 on December 31, 2015, $100,000 on December 31, 2016, and $200,000 on December 31, 2017. N's AIR from M is $425,000 for 2015, $450,000 for 2016, and $500,000 for 2017. On January 1, 2018, 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. M uses the account balance ratio method to attribute amounts to services performed in taxable years.

(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. The increase in N's account balance during 2015 is $50,000 ($50,000 – zero); the increase in N's account balance for 2016 is $50,000 ($100,000 − $50,000); and the increase in N's account balance for 2017 is $100,000 ($200,000 − $100,000). The sum of all the increases is $200,000 ($50,000 + $50,000 + $100,000). Accordingly, for N's 2015 taxable year, the attribution fraction is .25 ($50,000 / $200,000); for N's 2016, taxable year, the attribution fraction is .25 ($50,000 / $200,000); and for N's 2017 taxable year, the attribution fraction is .50 ($100,000 / $200,000).

(iii) With respect to the $200,000 payment made on January 1, 2018, $50,000 ($200,000 × .25) of DDR is attributable to services performed by N in M's 2015 taxable year; $50,000 ($200,000 × .25) of DDR is attributable to services performed by N in M's 2016 taxable year; and $100,000 ($200,000 × .50) of DDR is attributable to services performed by N in M's 2017 taxable year.

(iv) The $500,000 deduction limitation for 2015 is applied first to N's $425,000 of AIR for 2015. Because the deduction limit is greater than the AIR, M may deduct the entire $425,000 of AIR paid in 2015. The $500,000 deduction limit is then reduced to $75,000 by the amount of AIR against which it is applied ($500,000 − $425,000). The reduced deduction limit is then applied to N's $50,000 of DDR attributable to services performed by N in M's 2015 taxable year that is paid in 2018. Because $50,000 does not exceed the reduced deduction limit of $75,000, all $50,000 of the DDR attributable to services performed by N in M's 2015 taxable year is deductible for 2018, the year of payment. The deduction limit for remuneration attributable to services performed by N in 2015 is then reduced to $25,000 ($75,000 − $50,000), and this reduced limit is applied to any future payment of DDR attributable to services performed by N in 2015. With respect to M's 2016 taxable year, the $500,000 deduction limit for 2016 is applied first to N's $450,000 of AIR for 2016. Because the deduction limit is greater than the AIR, M may deduct the entire $450,000 of AIR paid in 2016. The $500,000 deduction limit is then reduced to $50,000 by the AIR ($500,000 − $450,000). The reduced deduction limit is then applied to N's $50,000 of DDR attributable to services performed by N in M's 2016 taxable year that is paid in 2018. Because $50,000 does not exceed the reduced deduction limit of $50,000, all $50,000 of the DDR attributed to M's 2016 taxable year is deductible for 2018, the year of payment. The deduction limit for remuneration attributable to services performed by N in 2016 is then reduced to zero, and this reduced limit is applied to any future payment of DDR attributable to services performed by N in 2016. With respect to M's 2017 taxable year, the $500,000 deduction limit for 2017 is applied first to N's $500,000 of AIR for 2017. Because the deduction limit is not greater than the AIR, M may deduct the entire $500,000 of AIR paid in 2017. The $500,000 deduction limit is then reduced to zero by the amount of the AIR against which it is applied ($500,000 − $500,000). The reduced deduction limit is applied to N's $100,000 of DDR attributable to services performed by N in M's 2017 taxable year that is paid in 2018. Because $100,000 exceeds the reduced deduction limit of zero, the $100,000 of the DDR attributed to services performed by N in M's 2017 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 2018 taxable year, and the remaining $100,000 is not deductible by M for any taxable year.

Example 4 (Installment payments and in-service payment attributable to multiple taxable years from an account balance plan using the account balance ratio 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 makes contributions 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 closing balances in O's account (including contributions, earnings, and distributions made during the year) are $100,000 on December 31, 2016, $250,000 on December 31, 2017, and $50,000 on December 31, 2018. O's AIR from L is $500,000 for 2016, $300,000 for 2017, and $450,000 for 2018. On December 31, 2018, L pays O $400,000 in accordance with the plan terms. On December 31, 2019, O's account balance is $200,000, reflecting additional credits of $125,000 made during the year and earnings on the account. O's AIR from L is $200,000 for 2019. O ceases providing services to L on December 31, 2019. On January 1, 2020, L pays O $200,000 in accordance with the plan terms. L uses the account balance ratio method to attribute amounts to services performed in taxable years.

(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. For purposes of attributing the $400,000 payment made on December 31, 2018 to a taxable year, the increase in O's account balance during 2016 is $100,000 ($100,000 – zero); the increase in O's account balance for 2017 is $150,000 ($250,000 − $100,000); and the increase in O's account balance for 2018 is $200,000 ($50,000 − $250,000 + $400,000 (payment on December 31, 2018)). The sum of all the increases is $450,000 ($100,000 + $150,000 + $200,000). Thus, for L's 2016 taxable year, the attribution fraction is .2222 ($100,000 / $450,000); for L's 2017 taxable year, the attribution fraction is .3333 ($150,000 / $450,000); and for L's 2018 taxable year, the attribution fraction is .4444 ($200,000 / $450,000). Accordingly, with respect to the $400,000 payment made on December 31, 2019, $88,889 ($400,000 × .2222) is attributable to services performed by O in L's 2016 taxable year; $133,333 ($400,000 × .3333) is attributable to services performed by O in L's 2017 taxable year; and $177,778 ($400,000 × .4444) is attributable to services performed by O in L's 2018 taxable year.

(iii) The portion of the $400,000 payment attributed to services performed in a disqualified taxable year under paragraph (d) of this section that exceeds the deduction limit for that disqualified taxable year, as reduced through the date of payment, is not deductible in any taxable year. The $500,000 deduction limit for 2016 is applied first to O's $500,000 of AIR for 2016. Because the deduction limit is equal to the $500,000 of AIR, L may deduct the entire $500,000 of AIR paid in 2016. The $500,000 deduction limit is then reduced to zero by the amount of the AIR ($500,000 − $500,000). The reduced deduction limit is applied to O's $88,889 of DDR attributable to services performed by O in L's 2016 taxable year that is paid in 2018. Because $88,889 exceeds the reduced deduction limit of zero, the $88,889 of DDR attributed to 2016 is not deductible for L's 2018 taxable year or any other taxable year. With respect to L's 2017 taxable year, the $500,000 deduction limitation for 2017 is applied first to O's $300,000 of AIR for 2017. Because the $500,000 deduction limit is greater than the $300,000 of AIR, L may deduct the entire $300,000 of AIR paid in 2017. The $500,000 deduction limit is reduced to $200,000 by the amount of the AIR ($500,000 − $300,000). The reduced deduction limit is then applied to O's $133,333 of DDR attributable to services performed by O in L's 2017 taxable year that is paid in 2018. Because $133,333 does not exceed that reduced deduction limit of $200,000, the $133,333 is deductible for 2018. The deduction limit for remuneration attributable to services performed by O in 2017 is then reduced to $66,667 ($200,000 − $133,333), and this reduced limit is applied to any future payment of DDR attributable to services performed by O in 2017. With respect to L's 2018 taxable year, the $500,000 deduction limit for 2018 is applied first to O's $450,000 of AIR for 2018. Because the deduction limit is greater than the AIR, L may deduct the entire $450,000 of AIR paid in 2017. The $500,000 deduction limit is reduced to $50,000 by the amount of the AIR ($500,000 − $450,000). The reduced deduction limit is applied to O's $177,778 attributable to services performed by O in L's 2018 taxable year that is paid in 2018. Because the $177,778 exceeds the reduced deduction limit of $50,000, $50,000 of DDR is deductible for L's 2018 taxable year, and $127,778 of the $177,778 is not deductible for L's 2018 taxable year or any other taxable year. As a result, $183,333 of the $400,000 payment ($0 + $133,333 + $50,000) is deductible by L for L's 2018 taxable year, and the remaining $216,667 is not deductible by L for any taxable year.

(iv) For purposes of attributing amounts paid or made available from the plan in future taxable years, the following adjustments are made to O's account balances to reflect the in-service payment of $400,000 in 2018. O's account balance as of December 31, 2016 is reduced by the $88,889 attributable to 2016; and for 2017 is reduced by the sum of the $133,333 attributable to 2017 and the $88,889 attributable to 2016. Therefore, after attributing the $400,000 payment, O's adjusted closing account balance as of December 31, 2016, is $11,111 ($100,000 − $88,889), and as of December 31, 2017, is $27,778 ($250,000 − $133,333 − $88,889).

(v) For purposes of attributing the $200,000 payment made on January 1, 2020, to services performed in the taxable years of S, the increase in O's account balance during 2016 is $11,111 ($11,111 – $0); the increase in O's account balance for 2017 is

$16,667 ($27,778 − $11,111); the increase in O’s account balance for 2018 is $22,222 ($50,000 − $27,778), and the increase in O’s account balance for 2019 is $150,000 ($200,000 − $50,000). The sum of all such increases is $200,000 ($11,111 + $16,667 + $22,222 + $150,000). Thus, for O’s 2016 taxable year, the attribution fraction is .0556 ($11,111 / $200,000); for O’s 2017, taxable year, the attribution fraction is .0833 ($16,667 / $200,000); for O’s 2018 taxable year, the attribution fraction is .1111 ($22,222 / $200,000); for O’s 2019 taxable year, the attribution fraction is .7500 ($150,000 / $200,000). Accordingly, with respect to the $200,000 payment made on January 1, 2020, $11,111 ($200,000 × .0556) of DDR is attributable to services performed by O in L’s 2016 taxable year; $16,667 ($200,000 × .0833) of DDR is attributable to services performed by O in L’s 2017 taxable year; $22,222 ($200,000 × .1111) of DDR is attributable to services performed by O in L’s 2018 taxable year; and $150,000 ($200,000 × .7500) of DDR is attributable to services performed by O in L’s 2019 taxable year.

(vi) The portion of the DDR attributed to a disqualified taxable year under paragraph (d) of this section that exceeds the deduction limit for that disqualified taxable year, as reduced, is not deductible for any taxable year. For L’s 2016 taxable year, the deduction limit is reduced to zero by the $500,000 of AIR for that year. Because $11,111 exceeds the reduced deduction limit of zero, $11,111 of the DDR is not deductible for L’s 2020 taxable year or any other taxable year. For L’s 2017 taxable year, the deduction limit is reduced to $200,000 by the $300,000 of AIR for that year and further reduced to $66,667 by the $133,333 of DDR previously attributed to 2017. Because $16,667 does not exceed the $66,667 deduction limit, the $16,667 of DDR is deductible for L’s 2020 taxable year, the year of payment. The deduction limit for remuneration attributable to services performed by O in 2017 is then reduced to $50,000 ($66,667 − $16,667), and this reduced limit is applied to any future payment attributable to services performed by O in 2017. For L’s 2018 taxable year, the deduction limit is reduced to zero by the $450,000 of AIR for that year and the $50,000 of DDR previously attributed to 2018. Because $22,222 exceeds the reduced deduction limit of zero for 2018, the $22,222 of DDR is not deductible for L’s 2020 taxable year or any other taxable year. For L’s 2019 taxable year, the $500,000 deduction limit for 2019 is applied first to O’s $200,000 of AIR for 2019. Because the deduction limit is greater than the AIR, L may deduct the entire $200,000 of AIR paid in 2019. The $500,000 deduction limit is reduced to $300,000 by the amount of the AIR ($500,000 − $200,000). The reduced deduction limit is applied to O’s $150,000 of DDR attributable to services performed by O in L’s 2019 taxable year that is paid in 2020. Because $150,000 does not exceed the $300,000 limit, the $150,000 of DDR is deductible for L’s 2020 taxable year, the year of payment. The deduction limit for remuneration attributable to services performed by O in 2019 is then reduced to $150,000 ($500,000 − $200,000 − $150,000), and this reduced limit is applied to any future payment attributable to services performed by O in 2019. As a result, $166,667 of the $200,000 payment ($0 + $16,667 + $0 + $150,000) is deductible by L for L’s 2020 taxable year, the year of payment, and the remaining $33,333 is not deductible by L for any taxable year.

Example 5 (Installment payments and in-service payment attributable to multiple taxable years from an account balance plan using the principal additions method). (i) The facts are the same as set forth in *Example 4*, paragraph (i), except that L uses the principal additions method for attributing remuneration from an account balance plan; principal additions under the plan are $100,000 in 2016, $125,000 in 2017, $150,000 in 2018, and $125,000 in 2019; as of the December 31, 2018 initial date of payment, earnings on the 2016, 2017, and 2018 principal additions are $40,000, $30,000, and $5,000 respectively. Under the terms of the plan, the $400,000 payment made on December 31, 2018, is from principal additions in 2016, 2017, and 2018, and earnings thereon, and the $200,000 payment made on January 1, 2020, is from principal additions in 2018 and 2019, and earnings thereon.

(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 rules in paragraph (d)(3)(ii) of this section, the $400,000 payment on January 1, 2019, is attributed to services performed by O in the taxable year to which the payment relates under the terms of the plan. DDR including principal additions and earnings thereon are attributed to services performed by O in a taxable year of L when the $400,000 payment is made to O on December 31, 2018. Under the terms of the plan, the $400,000 payment made on December 31, 2018 is attributed to services performed by O in L’s 2016 taxable year in the amount of $140,000, and is attributed to services performed by O in L’s 2017 taxable year in the amount of $155,000, and the remaining $105,000 ($400,000 − $140,000 − $155,000) is attributed to services performed by O in L’s 2018 taxable year.

(iii) The portion of the DDR attributable to services performed in a disqualified taxable year under paragraph (d) of this section that exceeds the deduction limit for that disqualified taxable year, as reduced, is not deductible for any taxable year. The $500,000 deduction limitation for 2016 is applied first to O’s $500,000 of AIR for 2016. Because the deduction limit is equal to the $500,000 of AIR, L may deduct the entire $500,000 of AIR paid in 2016. The $500,000 deduction limit is then reduced to zero by the amount of the AIR ($500,000 − $500,000). The reduced deduction limit is applied to O’s $140,000 of DDR attributable to services performed by O in L’s 2016 taxable year that is paid in 2018. Because $140,000 exceeds the reduced deduction limit of zero, the $140,000 is not deductible for L’s 2018 taxable year (the year of payment), or any other taxable year. For L’s 2017 taxable year, the $500,000 deduction limit for 2017 is applied first to O’s $300,000 of AIR for 2017. Because the deduction limit is greater than the AIR, L may deduct the entire $300,000 of AIR paid in 2017. The $500,000 deduction limit is then reduced to $200,000 by the amount of the AIR ($500,000 − $300,000). The reduced deduction limit is applied to O’s $155,000 of DDR attributable to services performed by O in L’s 2017 taxable year that is paid in 2018. Because $155,000 does not exceed the reduced deduction limit of $200,000, the $155,000 payment is deductible for 2018. For L’s 2018 taxable year, the $500,000 deduction limitation for 2018 is applied first to O’s $450,000 of AIR for 2018. Because the deduction limit is greater than the AIR, L may deduct the entire $450,000 of AIR paid in 2018. The $500,000 deduction limit is then reduced to $50,000 by the amount of the AIR ($500,000 − $450,000). The reduced deduction limit is applied to O’s $105,000 of DDR attributable to services performed by O in L’s 2018 taxable year that is paid in 2018. Because $105,000 exceeds the reduced deduction limit of $50,000, $55,000 of the $105,000 attributable to L’s 2018 taxable year is not deductible for 2018 (the year of payment), or any other taxable year. As a result, $205,000 of the $400,000 payment ($0 + $155,000 + $50,000) is deductible by L for L’s 2018 taxable year (the year of payment) and the remaining $195,000 is not deductible by L for any taxable year.

(iv) Earnings through January 1, 2020 on the principal addition for L’s 2018 taxable year ($50,000) that was not paid as part of the December 31, 2018 payment are $5,000. Earnings through January 1, 2020 on the $125,000 credited to O’s account on January 1, 2019 are $20,000. On December 31, 2018, after the $400,000 payment is applied to 2016, 2017, and 2018, the account balance for 2016 and 2017 is reduced to zero, and the account balance for 2018 is reduced to $50,000 ($150,000 + $5,000 (earnings) − $105,000). Under the terms of the plan, the $200,000 payment made on January 1, 2020, is attributable to services performed by O in L’s 2018 and 2019 taxable years. Therefore, the $200,000 payment on January 1, 2020 is attributed to services performed by O in L’s taxable years as follows: $55,000 ($50,000 + $5,000) to 2018 and $145,000 ($125,000 + $20,000) to 2019.

(v) The portion of the DDR attributed to a disqualified taxable year under paragraph (d) of this section that exceeds the deduction limit for that disqualified taxable year, as reduced, is not deductible for any taxable year. For L’s 2018 taxable year, the deduction limit is reduced to zero by the $450,000 of AIR for that year and the payment of $50,000 of DDR attributable to that year. Because $55,000 exceeds the reduced deduction limit of zero, the $55,000 is not deductible for 2020, the year of payment (or any other taxable year). With respect to L’s 2019 taxable year, the $500,000 deduction limit for 2019 is applied first to O’s $200,000 of AIR for 2019. Because the deduction limit is greater than the AIR, L may deduct the entire $200,000 of AIR paid in 2019. The $500,000 deduction limit is then reduced to $300,000 by the amount of the AIR ($500,000 − $200,000). The reduced deduction limit is applied to O’s $145,000 of DDR attributable to services performed by O in L’s 2019 taxable year that is paid in 2020. Because $145,000 does not exceed the $300,000 reduced limit, the $145,000 is deductible for 2020 (the year of payment). As a result, $145,000 of the $200,000 payment ($0 + $145,000) is deductible for L’s 2020 taxable year, and the remaining $55,000 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 AIR and DDR attributable to services performed by an applicable individual in a disqualified taxable year allowed for all members of an aggregated group that are 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 covered health insurance providers may otherwise deduct AIR or DDR attributable to services performed by an applicable individual in a disqualified taxable year, the AIR and DDR 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 AIR or DDR 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 limit (as reduced by previously deductible AIR or DDR, if applicable), the deduction limit is prorated based on the AIR or DDR otherwise deductible by the members of the aggregated group in the taxable year and allocated to each member of the aggregated group. The deduction limit allocated to each member of the aggregated group is determined by multiplying the deduction limit for the disqualified taxable year (as previously reduced, if applicable) by a fraction, the numerator of which is the AIR or DDR 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 AIR or DDR 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 AIR or DDR otherwise deductible by a member of the aggregated group in excess of the portion of the deduction limit allocated to that member is not deductible in any taxable year. If a covered health insurance provider is a member of more than one aggregated group, the deduction limit for that covered health insurance provider under section 162(m)(6) may in no event exceed $500,000 for AIR and DDR attributable to services performed by an applicable individual in a disqualified 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 DDR 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. At separate times during 2016, C is an employee of, and performs services for, I, J, and K. C's total AIR for 2016 is $1,500,000, which consists of $750,000 of AIR for services performed to K; $450,000 of AIR for services provided to J; and $300,000 of AIR for services to I.

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

Example 2. (i) The facts are the same as *Example 1*, except that C's total AIR 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 DDR attributable to services provided to K in 2016, which is payable (and paid) on April 1, 2018, and $75,000 of DDR attributable to services provided to J in 2016, which is payable (and paid) on April 1, 2019.

(ii) Because C's total AIR of $400,000 for 2016 for services provided to K, J, and I do not exceed the $500,000 limitation, K, J, and I may deduct $75,000, $150,000, and $175,000, respectively, for 2016. The deduction limit is then reduced to $100,000 by the total AIR deductible by all members of the aggregated group ($500,000 − $400,000). The deduction limit, as reduced, is then applied to any DDR attributable to services provided by C in 2016 in the first subsequent taxable year that DDR becomes deductible. The first year that DDR for 2016 becomes deductible is 2018, due to the $60,000 payment made on April 1, 2018. Because the $60,000 of DDR otherwise deductible by K does not exceed the 2016 $100,000 deduction limit, K may deduct the entire $60,000 for its 2018 taxable year. The $100,000 deduction limit is then reduced by the $60,000 of DDR deductible by K for 2018, and the reduced deduction limit of $40,000 ($100,000 − $60,000) is applied to the $75,000 of DDR that is otherwise deductible for 2019. Because the DDR of $75,000 otherwise deductible by J exceeds the reduced deduction limit 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 DDR of $75,000 attributable to services performed by C in J's 2016 taxable year is payable (and paid) on July 1, 2018.

(ii) The results are the same as *Example 2*, except that the reduced deduction limit of $100,000 is prorated between K and J in proportion to the DDR otherwise deductible by them for 2018. Accordingly, $44,444 of the remaining deduction limit is allocated to K ($100,000 × ($60,000 / $135,000)), and $55,556 of the remaining deduction limit is allocated to J ($100,000 × ($75,000 / $135,000)). Because the $60,000 of DDR otherwise deductible by K exceeds the $44,444 deduction limit 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 the 2018 taxable year or any other taxable year. Similarly, because the $75,000 of DDR otherwise deductible by J exceeds the $55,556 deduction limit 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*. 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 other 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 that did not previously include a health insurance issuer 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 will be a covered health insurance provider for its full 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, if it would otherwise be a covered health insurance provider under paragraph (b)(4), except as otherwise provided in this paragraph (f). For purposes of this section, the term *corporate transaction* means a merger, acquisition or disposition of assets or stock, reorganization, consolidation, separation, or any other transaction resulting in a change in the composition of an aggregated group.

(2) *Transition period relief for a person becoming a covered health insurance provider solely as a result of a corporate transaction*—(i) *In general*. Except as provided in paragraph (f)(2)(ii) 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)(2)(i)) become a covered health insurance provider solely because it becomes a member of an aggregated group with another person that is a health insurance issuer as a result of the corporate transaction, is not a covered health insurance provider subject to the deduction limitation of section 162(m)(6) for the taxable year of that person in which the corporate transaction occurs (the *transition period relief*).

(ii) *Certain applicable individuals*. The transition period relief described in paragraph (f)(2)(i) of this section does not apply with respect to the remuneration of any individual who is an applicable individual of a person that would have been a covered health insurance provider for the taxable year in which the corporate transaction occurred without regard to the occurrence of the corporate transaction (for example, the applicable individuals of a health insurance issuer and the members of its affiliated group that were covered health insurance issuers before the occurrence of a corporate transaction). This exception to the transition period relief applies 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. Accordingly, 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 a covered health insurance provider under the transition period relief described in paragraph (f)(1)(ii)(A) of this section, is subject to the deduction limitation of section 162(m)(6) for its taxable year in which the corporate transaction occurs with respect to AIR and DDR attributable to services performed by any individual who is an applicable individual of the acquired health insurance issuer and any member of its aggregated group that would have been a covered health insurance provider in the taxable year in which the corporate transaction occurred, even if the corporate transaction had not occurred.

(3) *Transition relief from the attribution consistency requirements*—(i) *In general*. Paragraphs (d)(3)(i), (d)(4)(i) and (d)(5)(i)(B) of this section require a covered health insurance provider and all members of its aggregated group to use the same method for attributing remuneration to services performed by applicable individuals consistently for all taxable years (*attribution consistency requirements*). As a result of a corporate transaction, however, a covered health insurance provider that uses an attribution method for its account balance plans, nonaccount balance plans, or stock options or SARs may become a member of an aggregated group with another covered health insurance provider that uses a different attribution method for those types of plans or arrangements. In that case, neither member of the aggregated group will be treated as violating the attribution consistency requirements merely because it uses an attribution method that is different from the attribution method used by another member of its aggregated group to attribute remuneration that becomes otherwise deductible in the taxable year in which the corporate transaction occurs. However, the attribution consistency requirements apply with respect to remuneration that becomes otherwise deductible in all subsequent taxable years. Following the date of the corporate transaction, any member of the aggregated group may change the attribution method that it used before the date of the corporate transaction to attribute remuneration under its account balance plans, nonaccount balance plans, or stock options or SARs to make its method consistent with the method used by any other member of the aggregated group. Notwithstanding the foregoing, the Secretary may subject this change in attribution method to limitations, or may otherwise modify the attribution consistency requirements, pursuant to a notice, revenue ruling, or other guidance of general applicability published in the Internal Revenue Bulletin.

(ii) *Exception for certain applicable individuals*. Notwithstanding the transition relief described in paragraphs (f)(2)(A) of this section, if a covered health insurance provider has attributed remuneration under a method described in paragraphs (d)(3), (d)(4), or (d)(5) of this section with respect to an applicable individual before a corporate transaction, the covered health insurance provider must continue at all times to use that attribution method for all other remuneration that becomes otherwise deductible under the same type of plan (that is, an account balance plan, a nonaccount balance plan, or a stock option or SAR) to which the applicable individual has a legally binding right as of the corporate transaction.

(4) *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 limit 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 limit under section 162(m)(6) for that short taxable year is $500,000 (and is not reduced to $125,000).

(5) *Effect of a corporate transaction on the application of the de minimis exception*. If a person becomes or ceases to be a member of an aggregated group, only the premiums and gross revenues of that person for the portion of its taxable year during which it is a member of the aggregated group are taken into account for purposes of determining whether the *de minimis* exception applies.

(6) *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)(v) 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 health insurance issuer that 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.

(ii) Corporation J is a covered health insurance provider for its short taxable year ending June 30, 2015. As a result of the merger, H becomes a covered health insurance provider for its 2015 taxable year, but Corporation H is not a covered health insurance provider for its 2015 taxable year by reason of the transition period relief in paragraph (f)(1)(ii)(A) of this section. However, applicable individuals of J continue to be subject to the deduction limit under section 162(m)(6) for amounts that become otherwise deductible in the 2015 taxable year and DDR that is attributable to services performed by applicable individuals of J, and H is a covered health insurance provider for 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)(A) of this section. D and E are not health insurance issuers (but are covered health insurance providers pursuant to paragraphs (b)(4)(i)(C) and (D) of this section). D is the parent entity of the DEF aggregated group. F's taxable year ends 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. The amount of premiums received by F from providing minimum essential coverage during the portion of its taxable year when it was a member of the DEF aggregated group constitute more than two percent of the gross revenues of the aggregated group for the taxable year of D (the parent entity) ending on December 31, 2016, and the taxable years of E and F ending with or within D's taxable year (December 31, 2016 and May 1, 2016 respectively). C and B are not health insurance issuers. C is the parent entity of the CBF aggregated group. The CBF aggregated group is also 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 CBF 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, and the de minimis exception does not apply because the amount of premiums received by F from providing minimum essential coverage during the short taxable year that it was a member of the DEF aggregated group are more than two percent of the gross revenues of the aggregated group for the taxable years during which the members would otherwise be a covered health insurance providers under paragraph (b)(4)(i) of this section. 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 covered health insurance providers for their taxable year ending December 31, 2016, by reason of the transition period relief of paragraph (f)(1)(ii)(A) of this section.

(iii) As a result of leaving the aggregated group, F has a new taxable year beginning on May 2, 2016 and ending on December 31, 2016. F is a covered health insurance provider within the meaning of paragraph (b)(4) of this section for its new taxable year ending on December 31, 2016 (even though C and B are not covered health insurance providers for their taxable years ending December 31, 2016) unless the CBF aggregated group qualifies for the *de minimis* exception for that taxable year.

(iv) P is an applicable individual whose remuneration from F is subject to the deduction limitation under section 162(m)(6) for F's short taxable year ending May 1, 2016 and F's taxable year ending December 31, 2016. In addition, any remuneration provided to P by C or B at any time for services provided by P from May 1, 2016 to December 31, 2016 is also subject to the deduction limitation under section 162(m)(6), even though C and B are not covered health insurance providers for their taxable years ending December 31, 2016 by reason of the transition period relief of paragraph (f)(1)(ii)(A) of this section. Remuneration to which P had the legally binding right on or before the date of the transaction is subject to the deduction limitation when that remuneration becomes otherwise deductible.

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 thus receives premiums from providing minimum essential coverage (instead of F), 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 and there are no other health insurance issuers in the BCF aggregated group, F is not a covered health insurance provider for its short, post-acquisition taxable year ending December 31, 2016.

(iii) With respect to P, remuneration to which P had the legally binding right on or before the date of the transaction is subject to the deduction limitation. However, remuneration to which P obtains the legally binding right after the date of the corporate transaction is not subject to the deduction limitation.

Example 4. (i) Corporations N, O, and P are members of an aggregated group as described in paragraph (b)(2) of this section. N is a health insurance issuer that is a covered health insurance provider pursuant to paragraph (b)(4)(i)(A) of this section, but neither O nor P is a health insurance issuer. P is the parent entity of the aggregated group. On April 1, 2016, O ceases to be a member of the NOP aggregated group as the result of a corporate transaction. O's taxable year does not end as a result of the corporate transaction.

(ii) Because O was a member of the NOP aggregated group during a portion of its taxable year, O is a covered health insurance provider for its taxable year ending December 31, 2016.

Example 5. (i) Corporations V, W, and X are members of an aggregated group as described in 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)(A) 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 June 30, 2017, W has $100x in gross revenue. For its taxable year ending September 30, 2016, X has $60x in gross revenue. For its taxable year ending December 31, 2016, V receives $4x of premiums from providing minimum essential coverage and has no other revenue. As of September 30, 2016, V ceases to be a member of the VWX aggregated group. V's taxable year does not end on September 30, 2016 as a result of the transaction. Of the $4x that that V receives for providing minimum essential coverage during its taxable year ending December 31, 2016, $3x is received during the period from January 1, 2016 through September 30, 2016. As a result of the corporate transaction, V's taxable year ends on September 30, 2016. The *de minimis* exception of paragraph (b)(4)(v)(A) of this section did not apply to the members of the VWX aggregated group for their immediately preceding taxable years ending December 31, 2015, June 30, 2016, and September 30, 2015, respectively.

(ii) For purposes of applying the *de minimis* exception to an aggregated group for a taxable year during which a person leaves or joins the aggregated group, only the premiums and revenues of the person for the portion of its taxable year during which it was a member of the aggregated group are taken into account. The premiums from providing minimum essential coverage received by the VWX aggregated group for W's taxable year ending June 30, 2017 are $3x. The revenues of the V, W, and X aggregated group for W's taxable year ending June 30, 2017 are $163x. Accordingly, the premiums received by the members of the aggregated group from providing minimum essential coverage are less than two percent of the gross revenues of the aggregated group ($3x is less than $3.26x (two percent of $163x)). Therefore, V, W and X are not covered health insurance providers for their taxable years ending December 31, 2016, June 30, 2017, and September 30, 2016, respectively.

Example 6. (i) The facts are the same as *Example 5*, except that F received $4x of premiums during the period from January 1, 2016 to September 30, 2016, and the members of the VWX aggregated group were not 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)(v)(A) of this section.

(ii) The premiums from providing minimum essential coverage received by the VWX aggregated group for W's taxable year ending June 30, 2017 are $4x. The revenues of the VWX aggregated group for W's taxable year ending June 30, 2017 are $164x. Accordingly, the premiums received by the members of the aggregated group from providing minimum essential coverage are greater than two percent of the gross revenues of the aggregated group ($4x is greater than $3.28x (two percent of $164x)). Therefore, V, W, and X do not qualify for the *de minimis* exception for their taxable years ending December 31, 2016, June 30, 2017, and September 30, 2016, respectively. However, V, W, and X are not covered health insurance providers for these taxable years by reason of the *de minimis* exception one year transition period described in paragraph (b)(4)(v)(B) of this section.

Example 7. (i) Corporation N is a health insurance issuer that is a covered health insurance provider. Corporation O is also a health insurance issuer that is a covered health insurance provider. Both N and O have taxable years ending December 31. N uses the account balance ratio method to attribute remuneration that becomes otherwise deductible under its account balance plans. O uses the principal additions method to attribute amounts that become otherwise deductible under its account balance plans. On June 30, 2016, O purchases all of the stock of N.

(ii) For the taxable year of N and O ending December 31, 2016, N may continue to attribute amounts that become deductible under its account balance plans using the account balance ratio method, and O can continue to attribute amounts that become otherwise deductible under its account balance plan using the principal additions method, even though they are members of the same aggregated group, pursuant to the transition period relief described in paragraph (f)(2) of this section. In all subsequent taxable years, N and O must use the same method to attribute amounts that become otherwise deductible under their account balance plans. Either N or O may change the method that it uses to attribute amounts under its account balance plans to be consistent with the attribution method used by the other.

Example 8. (i) The facts are the same as *Example 7*. In addition, B is an applicable individual of N before the corporate transaction and is a participant in an account balance plan of N. On December 31, 2015, N made a payment to B, and N used the account balance ratio method described in paragraph (d)(3)(ii) of this section to attribute the payment to services performed by B in taxable years of N.

(ii) Because N used the account balance ratio method described in paragraph (d)(3)(ii) of this section to attribute an amount that became otherwise deductible under the plan before the corporate transaction, N must continue to use the account balance ratio method for attributing amounts to which B had a legally binding right as of the corporate transaction, whenever those amounts become otherwise deductible.

(g) *Coordination*—(1) *Coordination with section 162(m)(1)*. If section 162(m)(1) and section 162(m)(6) both otherwise would 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 AIR or DDR of the applicable individual for a taxable year but for the deduction for the AIR or DDR 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 AIR 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 limit to $200,000 ($500,000 − $300,000). Therefore, A may deduct only $200,000 of the $750,000 in AIR, 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 (*grandfathered amounts*). 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 described in paragraph (h)(2) of this section.

(2) *Identification of services performed in taxable years beginning before January 1, 2010*—(i) *In general*. DDR described in paragraphs (d)(2) (legally binding right), (d)(3) (account balance plans), (d)(4) (nonaccount balance plans), (d)(6) (involuntary separation pay), (d)(7) (reimbursements), and (d)(8) (split dollar life insurance) of this section 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 the rules of these paragraphs, without regard to whether that remuneration is subject to a substantial risk of forfeiture on or after that date. Notwithstanding the requirement under paragraph (d)(3)(i) of this section that a covered health insurance provider must use the same attribution method for its account balance plans for all taxable years, a covered health insurance provider that uses the account balance ratio method described in paragraph (d)(3)(i) of this section to attribute remuneration to services performed in taxable years beginning after December 31, 2009 may use the principal additions method described in paragraph (d)(3)(ii) of this section to attribute remuneration under an account balance plan to services performed in a taxable year beginning before January 1, 2010 for purposes of determining grandfathered amounts under the plan. (See paragraph (d)(3)(ii)(C)(*3*) of this section for required account balance adjustments if a covered health insurance provider generally uses the account balance ratio method to attribute amounts otherwise deductible under its account balance plans but uses the principal additions method to attribute remuneration to services performed in taxable years beginning before January 1, 2010.)

(ii) *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 DDR*—(1) *Transition rule for DDR 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 DDR 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 DDR 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 AIR and DDR deductible in those taxable years.

(2) *Examples*. 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 DDR 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 AIR from Z for 2012, and becomes entitled to $800,000 of DDR that is attributable to services performed by Q in 2012. Z pays Q $350,000 of the DDR in 2015, and the remaining $450,000 of the DDR in 2016. These payments are otherwise deductible by Z in 2015 and 2016, respectively.

(ii) DDR 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, DDR 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 AIR and DDR attributable to services performed by Q in 2012 is determined by reducing the $500,000 deduction limit by the $200,000 of AIR 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 limit of $300,000 for the 2012 taxable year is applied against the $350,000 payment made in 2015, and accordingly, the deduction limit is not reduced by the amount of that payment. The reduced deduction limit is then applied to Q's $450,000 of DDR attributable to services performed by Q in 2012 that is paid to Q and becomes otherwise deductible in 2016. Because the reduced deduction limit of $300,000 is less than the $450,000 otherwise deductible by Z in 2016, Z may deduct only $300,000 of the DDR, 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 DDR payable on a fixed schedule in 2011, 2012, and 2013. Pursuant to the fixed schedule, Y pays R $50,000 of DDR in 2011, $50,000 of DDR in 2012, and the remaining $100,000 of DDR in 2013.

(ii) Because the deduction limitation for DDR under section 162(m)(6)(A)(ii) is effective for DDR 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 DDR 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 limit by the $400,000 of AIR paid to R for 2010 ($500,000 − $400,000). The reduced deduction limit of $100,000 is further reduced to zero by the $50,000 of DDR 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 limit is reduced to zero, none of the $100,000 of DDR 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 are effective on September 23, 2014. The regulations apply to taxable years beginning on or after September 23, 2014.

John Dalrymple
Deputy Commissioner
for Services and Enforcement.

Approved September 15, 2014.

Mark J. Mazur
Assistant Secretary of the
Treasury (Tax Policy)

(Filed by the Office of the Federal Register on September 18, 2014, 4:15 p.m. and published in the issue of the federal Register for September 23, 2014, 79 F.R. 56892)

Section 412.—Minimum Funding Standards

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 2014. See Rev. Rul. 2014-26, page 663.

Section 446.—General Rule for Methods of Accounting

Procedures are provided by which a taxpayer may obtain the automatic consent of the Commissioner of Internal Revenue to change to the methods of accounting provided in §§ 1.168(i)–1, 1.168(i)–7, and 1.168(i)–8 of the Income Tax Regulations (T.D. 9689). Procedures are also provided allowing a late partial disposition election under § 1.168(i)–8 to be treated as a change in method of accounting for a limited period of time. Finally, modifications are made to section 10.11 of the APPENDIX of Rev. Proc. 2011–14 regarding a change to the method of accounting described in Rev. Proc. 2014–16, 2014–9 I.R.B. 606, for amounts paid to acquire, produce, or improve tangible property. Modifications are made to the procedures in Rev. Proc. 2014–17, 2014–12 I.R.B. 661, and Rev. Proc. 2011–14, 2011-4 I.R.B. 330, regarding certain changes in method of accounting for dispositions of tangible depreciable property. See Rev. Proc. 2014–54, page 663.

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

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 2014. See Rev. Rul. 2014–26, page 663.

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

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 2014. See Rev. Rul. 2014–26, page 663.

Section 482.—Allocation of Income and Deductions Among Taxpayers

Federal short-term, mid-term, and long-term rates are set forth for the month of October 2014. See Rev. Rul. 2014–26, page 663.

Section 483.—Interest on Certain Deferred Payments

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 2014. See Rev. Rul. 2014–26, page 663.

Section 642.—Special Rules for Credits and Deductions

Federal short-term, mid-term, and long-term rates are set forth for the month of October 2014. See Rev. Rul. 2014–26, page 663.

Section 807.—Rules for Certain Reserves

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 2014. See Rev. Rul. 2014–26, page 663.

Section 846.—Discounted Unpaid Losses Defined

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 2014. See Rev. Rul. 2014–26, page 663.

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

(Also Sections 42, 280G, 382, 412, 467, 468, 482, 483, 642, 807, 846, 1288, 7520, 7872.)

Rev. Rul. 2014–26

This revenue ruling provides various prescribed rates for federal income tax purposes for October 2014 (the current month). Table 1 contains the short-term, mid-term, and long-term applicable federal rates (AFR) for the current month for purposes of section 1274(d) of the Internal Revenue Code. Table 2 contains the short-term, mid-term, and long-term adjusted applicable federal rates (adjusted AFR) for the current month for purposes of section 1288(b). Table 3 sets forth the adjusted federal long-term rate and the long-term tax-exempt rate described in section 382(f). Table 4 contains the appropriate percentages for determining the low-income housing credit described in section 42(b)(1) for buildings placed in service during the current month. However, under section 42(b)(2), the applicable percentage for non-federally subsidized new buildings placed in service after July 30, 2008, with respect to housing credit dollar amount allocations made before January 1, 2014, shall not be less than 9%.

Finally,Table 5 contains the federal rate for determining the present value of an annuity, an interest for life or for a term of years, or a remainder or a reversionary interest for purposes of section 7520.

REV. RUL. 2014–26 TABLE 1
Applicable Federal Rates (AFR) for October 2014
Period for Compounding

	Annual	*Semiannual*	*Quarterly*	*Monthly*
		Short-term		
AFR	.38%	.38%	.38%	.38%
110% AFR	.42%	.42%	.42%	.42%
120% AFR	.46%	.46%	.46%	.46%
130% AFR	.49%	.49%	.49%	.49%
		Mid-term		
AFR	1.85%	1.84%	1.84%	1.83%
110% AFR	2.03%	2.02%	2.01%	2.01%
120% AFR	2.22%	2.21%	2.20%	2.20%
130% AFR	2.40%	2.39%	2.38%	2.38%
150% AFR	2.78%	2.76%	2.75%	2.74%
175% AFR	3.25%	3.22%	3.21%	3.20%
		Long-term		
AFR	2.89%	2.87%	2.86%	2.85%
110% AFR	3.18%	3.16%	3.15%	3.1%
120% AFR	3.47%	3.44%	3.43%	3.42%
130% AFR	3.76%	3.73%	3.71%	3.70%

REV. RUL. 2014–26 TABLE 2
Adjusted AFR for October 2014
Period for Compounding

	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-term adjusted AFR	.38%	.38%	.38%	.38%
Mid-term adjusted AFR	1.27%	1.27%	1.27%	1.27%
Long-term adjusted AFR	2.77%	2.75%	2.74%	2.73%

REV. RUL. 2014–26 TABLE 3
Rates Under Section 382 for October 2014

Adjusted federal long-term rate for the current month	2.77%
Long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months.)	3.05%

REV. RUL. 2014–26 TABLE 4
Appropriate Percentages Under Section 42(b)(1) for October 2014

Note: Under section 42(b)(2), the applicable percentage for non-federally subsidized new buildings placed in service after July 30, 2008, with respect to housing credit dollar amount allocations made before January 1, 2014, shall not be less than 9%.

Appropriate percentage for the 70% present value loW–income housing credit	7.54%
Appropriate percentage for the 30% present value loW–income housing credit	3.23%

REV. RUL. 2014–26 TABLE 5
Rate Under Section 7520 for October 2014

Applicable federal rate for determining the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest	2.2%

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

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 2014. See Rev. Rul. 2014–26, page 663.

Section 7520.—Valuation Tables

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 2014. See Rev. Rul. 2014–26, page 663.

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

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 2014. See Rev. Rul. 2014–26, page 663.

Part III. Administrative, Procedural, and Miscellaneous

Section 4980H.—Shared Responsibility for Employers Regarding Health Coverage – Approach to Changes in Measurement Periods or Methods Applicable to an Employee

Notice 2014–49

PURPOSE

This notice describes a proposed approach to the application of the look-back measurement method, which may be used to determine if an employee is a full-time employee for purposes of § 4980H of the Internal Revenue Code (Code), in situations in which the measurement period applicable to an employee changes. This change may occur because the employee transfers within the same applicable large employer (or within the same applicable large employer member (ALE member)) from a position to which one measurement period applies to a position to which a different measurement period applies. This situation may also arise when the ALE member modifies the measurement period applicable to a position. This notice is intended to address the topics for which guidance was anticipated in section VII.G of the preamble to the final § 4980H regulations (79 FR 8544, 8563 (Feb. 12, 2014)).

The Treasury Department and the IRS invite comments on this proposed approach. However, taxpayers may rely on the approach proposed in this notice until further guidance is issued, and in any case through the end of the 2016 calendar year.

The look-back measurement method generally involves using an employee's average hours of service per week during a period (referred to in this notice as a measurement period and in the final § 4980H regulations as either an initial measurement period or a standard measurement period, depending on the circumstances) to determine if an employee is a full-time employee during a subsequent period (referred to both in this notice and the final regulations as a stability period).[1] The look-back measurement method is one of two alternative methods for identifying full-time employees for purposes of determining whether an ALE member is potentially subject to a payment under § 4980H. Under § 54.4980H–3(d)(1)(v), each ALE member that uses the look-back measurement method may establish its own measurement and stability periods, subject to rules on maximum and minimum period lengths, and may also establish different measurement and stability periods for different specified categories of employees.

This notice addresses application of the look-back measurement method to the following situations:

(1) An employee in a position to which one measurement period applies transfers within the same applicable large employer (whether or not within the same ALE member) to a position to which a different measurement period applies (for example, an employee moves from an hourly position to which a 12-month measurement period applies to a salaried position to which a 6-month measurement period applies); and

(2) An ALE member changes the measurement method applicable to employees within a permissible category (for example, an ALE member changes the measurement period for all hourly employees for the next calendar year from a 6-month to a 12-month measurement period).

This notice describes how to address these situations, in both the case in which the employee is in a stability period at the time of the transfer and the case in which the employee is not yet in a stability period at that time. In general, for an employee who has been employed for a full measurement period at the time of transfer (and thus has a status as either a full-time employee or non-full-time employee for the stability period associated with that measurement period), the employee retains his or her status through the end of the associated stability period. For an employee who is not in a stability period (or administrative period) at the time of transfer, the employee's status is determined using the measurement period applicable to the second position, but including hours of service in the first position in applying that measurement period.

BACKGROUND

A. Section 4980H—In General

The Patient Protection and Affordable Care Act (Pub. L. 111–148) was enacted on March 23, 2010. The Health Care and Education Reconciliation Act of 2010 (Pub. L. 111–152) was enacted on March 30, 2010. These statutes are collectively known as the Affordable Care Act. The Affordable Care Act added Section 4980H to the Code, and that section was amended by the Department of Defense and Full-Year Continuing Appropriations Act, 2011 (enacted April 15, 2011, Pub. L. No. 112–10). Section 4980H applies to applicable large employers (generally, employers who employed at least 50 full-time employees, including full-time equivalent employees, on business days during the preceding calendar year).

Section 4980H generally provides that an applicable large employer is subject to an assessable payment if either (1) § 4980H(a) applies because the employer fails to offer its full-time employees (and their dependents) the opportunity to enroll in minimum essential coverage under an eligible employer-sponsored plan and any full-time employee is certified to receive a premium tax credit or cost-sharing reduction; or (2) § 4980H(b) applies because the employer offers its full-time employees (and their dependents) the opportunity to enroll in minimum essential coverage and one or more full-time employees is certified to receive a premium tax credit or cost-sharing reduction. Section 4980H is generally applicable for months beginning after December 31, 2013; however, Notice 2013–45 provides transition relief under which § 4980H does not apply for 2014.

[1]Unless otherwise noted, all terms used in this notice have the same meaning as provided in the final § 4980H regulations.

B. Section 4980H—Identification of Full-Time Employees

Section 4980H(c)(4) provides that a full-time employee for any month is an employee who is employed on average at least 30 hours of service per week. The final § 4980H regulations (79 FR 8544 (Feb. 12, 2014)) provide two alternative methods for determining if an employee is a full-time employee for purposes of § 4980H: (1) the monthly measurement method; and (2) the look-back measurement method.

Under the monthly measurement method, an employee generally is treated as a full-time employee for any calendar month in which the employee averages 30 or more hours of service per week. See § 54.4980H–3(c)(1). Under the look-back measurement method, an employee generally is treated as a full-time employee for any month within a stability period if the employee averaged 30 or more hours of service per week during the applicable measurement period preceding the stability period. See § 54.4980H–3(d)(1). The look-back measurement method for identifying full-time employees is available only for determining potential liability under § 4980H and not for determining status as an applicable large employer.

An employer that uses the look-back measurement method sets the starting date and length of two separate measurement periods: (1) the standard measurement period, which is used for ongoing employees (generally, all employees who have been employed for at least one full standard measurement period); and (2) the initial measurement period, which is used for new variable hour, seasonal, or part-time employees.[2] Each ALE member (that is, each separate entity within a group of entities that constitutes a single applicable large employer) may establish different measurement methods or may use measurement periods that differ in duration or that start on a different date, and each ALE member is also permitted to use different measurement methods or to use measurement periods that differ in duration or that start on a different date for certain specified categories of employees. These categories are (A) collectively bargained and non-collectively bargained employees, (B) each group of collectively bargained employees covered by a separate collective bargaining agreement, (C) salaried employees and hourly employees, and (D) employees whose primary places of employment are in different States. See § 54.4980H–3(d)(1)(v).

PROPOSED APPROACH

This section III proposes an approach for applying the look-back measurement method if the measurement period applicable to a particular employee changes. Section III.A addresses situations in which an employee transfers from one position to another within the same applicable large employer (or ALE member), in cases in which the employer uses a different measurement period for each position. Section III.B addresses situations in which the employer changes the measurement period applicable to one or more categories of employees, and also addresses situations in which an employer changes the measurement method (in other words, from the look-back measurement method to the monthly measurement method or vice versa) for one or more categories of employees.

Nothing in this notice is intended to prohibit or discourage employers from adopting eligibility provisions that make some employees eligible for coverage before they would be considered a full-time employee under this approach.

A. Employee transferring from a position to which one measurement period applies to a position to which a different measurement period applies.

This section III.A addresses changes in measurement methods under the following circumstances: the employee, who has been employed by an ALE member in a position (referred to as the first position) for which the employer uses the look-back measurement method, transfers to another position (referred to as the second position) for the same applicable large employer (whether or not with the same ALE member) for which the employer also uses the look-back measurement method, but with a measurement period that is different from the measurement period applicable to the first position. For this purpose, two measurement periods are different if they are of different durations or if they start on different dates (or both).

A transfer that may result in a change of applicable measurement method includes a transfer from one ALE member to another ALE member of the same applicable large employer or a transfer from one category of employees identified in § 54.4980H–3(d)(1)(v) to another.

For purposes of this proposed approach, following a transfer, an employer includes hours of service earned in the first position either by (1) counting the hours of service using the counting method applied to the employee in the first position (for example, using a weekly equivalency method for non-hourly employees), or (2) recalculating the hours of service earned in the first position using the hours of service counting method applied to the employee in the second position (for example, using a monthly equivalency method for non-hourly employees), provided that the employer treats all similarly situated employees consistently.

1. Proposed Approach to Application of Look-Back Measurement Method

Beginning with the date on which an employee described above transfers from the first position to the second position, the look-back measurement method is applied as follows:

(i) *Employees in a stability period or administrative period*. If an employee is in a stability period applicable to the first position as of the date of transfer, the employee's status as a full-time or non-full-time employee for the first position remains in effect until the end of that stability period. For this purpose, an employee is deemed to be in a stability period if as of the date of transfer the employee has been assigned a status for that stability period as a result of having been employed by the ALE member for a full standard measurement period or, if the employee has been a new variable hour, part-time, or seasonal employee, for a full initial measurement period.

[2] An initial measurement period does not apply to new employees who are full-time employees (because they are reasonably expected at time of hire to average at least 30 hours of service per week for the months after hire), and so are not variable-hour, seasonal, or part-time employees. See § 54.4980H–3(d)(2).

Similarly, in the case of a new employee who is in an administrative period immediately following the end of the initial measurement period as of the date of transfer, the employee's status as a full-time or non-full-time employee based on hours of service in the initial measurement period under the first position will apply from the start of the associated stability period following the end of that administrative period through the end of that stability period.

At the end of the stability period during which the transfer occurs (or, if the employee was in an administrative period at the date of transfer, the end of the immediately following stability period), the employee assumes the full-time employee or non-full-time employee status that the employee would have under the look-back measurement method applicable to the second position, but including hours of service in the first position when applying that measurement method. For this purpose, if an employee's status in the second position cannot be determined under the measurement method applicable to the second position because, for example, the employee is a variable hour employee and, even including service performed in the first position, has not yet been employed for a full initial measurement period for the second position (and the administrative period immediately following that measurement period for the second position), then the rule in section III.A.1.ii applies to the employee in the second position.

(ii) *Employees not in a stability period*. If an employee is not in a stability period or in an administrative period immediately following the end of the initial measurement period under the look-back measurement method applicable to the first position as of the date of transfer as determined in paragraph (i) above, the employee's status as a full-time or non-full-time employee is determined solely under the look-back measurement method applicable to the second position as of the date of transfer, including all hours of service in the first position.

In all other respects, the rules generally applicable to the look-back measurement method under § 54.4980H–3(d) continue to apply. For example, whether a new employee is a variable hour, part-time, seasonal, or full-time employee is determined based on the applicable large employer's reasonable expectations at the time of hire in accordance with § 54.4980H–3(d)(2). However, a transfer of a new variable hour, part-time, or seasonal employee from the first position to the second position may be a change in employment status described in § 54.4980H–3(d)(3)(vii), if after the transfer the employee is reasonably expected to average at least 30 hours of service per week in the second position.

As provided in the final § 4980H regulations, a new employee who is not a variable hour or seasonal employee and who is reasonably expected to average at least 30 hours of service per week at the time of hire (and so is expected to be a full-time employee) is not subject to an initial measurement period. Instead, the status of such a new employee as a full-time employee or non-full-time employee for § 4980H purposes is determined on the basis of hours of service in each month. See § 54.4980H–3(d)(2)(i). Such a new employee by definition will never be in a stability period for purposes of this section A.1.ii (unless the employee has been employed for a full standard measurement period at the date of transfer, in which case the employee would be a continuing rather than a new employee).

Until a new employee described in the preceding paragraph has been employed for a full standard measurement period applicable to the second position (including service in the first position), the status of the employee as a full-time or non-full-time employee for § 4980H purposes continues to be determined on the basis of hours of service in each calendar month. If such an employee has been employed for a full standard measurement period applicable to the second position but not the first position as of the date of transfer, the employee's status as a full-time or non-full-time employee is determined on the basis of the employee's average hours of service during that standard measurement period for the second position (but counting the hours of service accumulated during that standard measurement period for the first position), applied starting on the first day of the first month following the date of transfer and continuing through the end of the associated stability period.

2. Examples

The following examples illustrate the approach described in section III.A.1 of this notice. For each example, Position 1 and Position 2 are two positions at the same applicable large employer. Except as otherwise noted, the employer does not apply an optional administrative period described in § 54.4980H–3(d)(1)(vi) or § 54.4980H–3(d)(3)(vi).

Example 1: Ongoing employee. For Position 1, the employer uses 12-month standard measurement and stability periods beginning January 1. For Position 2, the employer uses 12-month standard measurement and stability periods beginning July 1.

Employee A is a long-time employee in Position 1 and so is not in an initial measurement period during the relevant periods. Employee A continues working in Position 1 and averages less than 30 hours of service per week during the period from January 1, 2015 through December 31, 2015. Employee A averages 30 or more hours of service per week during the period from July 1, 2015 through June 30, 2016.

On August 15, 2016, Employee A transfers from Position 1 to Position 2. At the date of the transfer, Employee A is in a stability period under Position 1 under which Employee A is treated as a non-full-time employee because Employee A averaged less than 30 hours of service per week during the measurement period applicable to Position 1 beginning January 1, 2015 and ending December 31, 2015. For the period from August 15, 2016 through December 31, 2016 (the end of the stability period for Position 1 during which the transfer occurs), Employee A retains his status as a non-full-time employee (although the employer may choose to nonetheless extend an offer of coverage to the employee).

As of January 1, 2017 (the date immediately following the end of the stability period for Position 1), Employee A's status is determined under the look-back measurement method applicable to Position 2. Employee A is a full-time employee starting January 1, 2017, because Employee A averaged 30 or more hours of service per week in the measurement period for Position 2 beginning July 1, 2015 and ending June 30, 2016 (which has a stability period of July 1, 2016 through June 30, 2017). Employee A remains a full-time employee through the end of that stability period (in other words, through June 30, 2017). After June 30, 2017, Employee A's status continues to be determined using the applicable measurement period for Position 2.

Example 2: New variable hour employee in initial measurement period transfers to position in which employee has completed initial measurement period. For Position 1, the employer uses 12-month standard measurement and stability periods beginning January 1 and a 12-month initial measurement period beginning on each employee's start date. For Position 2, the employer uses 6-month standard measurement and stability periods beginning January 1 and July 1 and a 6-month initial measurement period beginning on an employee's start date.

The employer hires Employee B into Position 1 as a new variable-hour employee on January 1, 2015. Employee B averages 30 or more hours of service per week during the period from January 1 through June 30, 2015. On October 1, 2015, at which time Employee B is in the initial measurement period for Position 1, Employee B transfers from Position 1 to Position 2.

At the date of the transfer, Employee B is not in a stability period for Position 1 because Employee B has not been employed for a full initial measurement period or a full standard measurement period. Accordingly, Employee B's status is determined under the measurement method applicable to Position 2 as of the date of transfer, taking into account Employee B's hours of service in Position 1.

Employee B is a full-time employee from the date of transfer (October 1, 2015) through the end of the applicable stability period for Position 2 (December 31, 2015) because Employee B averaged 30 or more hours of service per week during the applicable measurement period for Position 2 ending June 30, 2015 (for Employee B, the initial measurement period and standard measurement period ran simultaneously from January 1, 2015 through June 30, 2015). After December 31, 2015, Employee B's status continues to be determined using the applicable measurement period for Position 2.

Example 3: New variable hour employee in initial measurement period transfers to position in which employee is also in initial measurement period. For Position 1, the employer uses a 3-month initial measurement period that begins on the first day of the month following the start date and, if the employee is full-time during the initial measurement period, a 6-month stability period immediately following the initial measurement period. For Position 2, the employer uses a 12-month initial measurement period beginning on each employee's start date, applies an administrative period that runs from the end of the initial measurement period until the end of the month in which that date falls, and uses a one-year stability period starting the day after the end of the administrative period.

The employer hires Employee C into Position 1 as a new variable-hour employee on February 15, 2015. On May 1, 2015, Employee C transfers from Position 1 to Position 2. Employee C is not reasonably expected to average 30 or more hours of service per week in Position 2 (and thus the transfer from Position 1 to Position 2 does not constitute a change in employment status for purposes of § 54.4980H–3(d)(3)(vii)). Employee C does not average 30 or more hours of service per week during the period from February 15, 2015 through February 14, 2016.

As of the date of transfer, Employee C had not been employed for the full initial measurement period for Position 1 and so, as of the date of transfer, Employee C is not in a stability period. Accordingly, Employee C's status is determined using the measurement method applicable to Position 2 (February 15, 2015 through February 14, 2016).

Employee C continues to be treated as a new variable hour employee from the date of transfer through February 28, 2016 (the end of the initial measurement period and associated administrative period for Position 2). For the stability period beginning March 1, 2016, Employee C's status is determined on the basis of Employee C's average hours of service in the initial measurement period for Position 2, taking into account the hours of service in Position 1. Employee C is not a full-time employee for the stability period from March 1, 2016 through February 28, 2017.

Example 4: New variable hour employee in initial measurement period transfers to new position and has a change in employment status. Same facts as *Example 3*, except that as of the date of transfer Employee C is reasonably expected to average 30 or more hours of service per week in Position 2.

Because Employee C had not been employed for the full initial measurement period for Position 1, Employee C is not in a stability period as of the date of transfer. Accordingly, Employee C's status is determined using the measurement method for Position 2.

Because as of the date of transfer to Position 2, Employee C is reasonably expected to average more than 30 hours of service per week in Position 2, the rules set forth in § 54.4980H–3(d)(3)(vii) for changes in employment status during the initial measurement period apply.

Example 5: Transfer of employee during administrative period. For Position 1, the employer uses a 12-month standard measurement period starting January 1 for ongoing employees and an 11-month initial measurement period starting on the first day of the month following the start date combined with a one-month administrative period for new variable hour, part-time, and seasonal employees. With respect to Position 2, the employer uses 6-month standard measurement and stability periods beginning January 1 and July 1.

The employer hires Employee D into Position 1 on March 15, 2016 as a new variable hour employee. For the 11-month initial measurement period from April 1, 2016 through February 28, 2017, Employee D averages 30 or more hours of service per week. On March 10, 2017, during the administrative period for Position 1 from March 1, 2017 through March 31, 2017, Employee D transfers from Position 1 to Position 2.

The date of transfer occurs during the administrative period following the completion of Employee D's initial measurement period applicable to Position 1. Employee D's status must be determined using the initial measurement method applicable to Position 1 and applied from the start of the stability period following the end of the administrative period through the end of that stability period.

Accordingly, for the 12-month stability period starting April 1, 2017, Employee D is a full-time employee because Employee D averaged 30 or more hours of service per week in the associated initial measurement period ending February 28, 2017. After the completion of the stability period (March 31, 2018), Employee D's status as a full-time employee is determined using the measurement method applicable to Position 2.

B. Employer-initiated changes in measurement methods for one or more permissible categories of employees.

Pursuant to this notice, an employer may change the measurement method applicable to a category of employees identified in § 54.4980H–3(d)(1)(v), provided that for a transition period following the date of any such change, the status of each employee in that category is determined in accordance with this section III.B. A change in measurement method may include a change from the look-back measurement method to the monthly measurement method (or vice versa), or a change in the duration or start date of any applicable measurement period under the look-back measurement method.

The § 4980H final regulations address how to determine the full-time status of employees who transfer from a category to which the monthly measurement method applies to a category to which the look-back measurement method (or vice versa). See § 54.4980H–3(f)(1). The final regulations do not address whether, or under what conditions, an employer that uses a measurement method for a category of employees may subsequently change that measurement method. This section III.B clarifies that an employer may change the measurement method applicable to a category of employees, provided that the transition rules for employees who change between the monthly and look-back measurement methods due to such a change by the employer as provided in § 54.4980H–3(f)(1) apply to all employees impacted by the change for a transition period after the effective date of the change in method. For a change from the look-back measurement method to the monthly measurement method (or vice versa), the status of each affected employee as of the date of the change is determined in accordance with § 54.4980H–3(f)(1) as if on the date of the change each of those employees had transferred from a position to which the original measurement method applied, to a position to which the revised measurement method applied.

The status of any employee whose applicable measurement period under the look-back measurement method is changed by the employer is determined as if the employee had transferred from a position to which the original measurement method applies to a position to which the revised measurement method applies as of the effective date of the change. Accordingly, if an employer changes the duration or start date of the measurement period under the look-back measurement method for a category of employees, the status of each employee in that category as a full-time employee after the date of the change is determined in accordance with this notice as if on the date of the change each employee in the category had transferred from a position to which the original measurement method applied, to a position to which the revised measurement method applied.

Example 6: Employer-initiated change in measurement periods. Starting January 1, 2015, the employer determines the full-time employee status of employees covered by a particular collective bargaining agreement (CBA) using 6-month measurement and stability periods each starting April 1 and October 1 and determines the status of employees not covered by the CBA using 12-month measurement and stability periods each starting January 1.

On April 1, 2017, the employer changes the look-back measurement method for employees not covered by the CBA to be the same as that used for employees covered by the CBA.

For a transition period following the date of this change, the status of employees not covered by the CBA must be made in a manner consistent with this notice, treating each employee who is subject to the measurement method applicable to employees not covered by the CBA as if on April 1, 2017, that employee had transferred from a position subject to the original measurement method to a position subject to the revised measurement method.

Accordingly, each employee subject to the measurement method applicable to employees not covered by the CBA who is in a stability period as of April 1, 2017 retains his or her status as a full-time employee or non-full-time employee, as determined under the original measurement method for the remainder of the 12-month stability period applicable to that employee. Each such employee who is not in a stability period as of April 1, 2017 has his or her status determined as of April 1, 2017 in accordance with the 6-month measurement method.

RELIANCE

The Treasury Department and the IRS anticipate issuing further guidance after consideration of all comments received pursuant to section V of this notice. However, taxpayers may rely on the approach described in this notice to determine an employee's status as a full-time employee for purposes of § 4980H until such guidance is issued, and in any case, through the end of calendar year 2016.

REQUEST FOR COMMENTS AND APPLICATION TO CORPORATE TRANSACTIONS

The Treasury Department and the IRS invite public comments on the proposed approached described in this notice, and on the potential application of the proposed approach described in this notice, or similar rules, in the context of a corporate transaction such as a merger or acquisition involving employers using different measurement methods. In such a corporate transaction, the two (or more) entities may have different measurement methods for their respective employees in a particular category under § 54.4980H–3(d)(1)(v) (for example, salaried employees). As a result of the corporate transaction, these groups of employees may become employed by the same ALE member.

Until further guidance is issued, and in any case through the end of calendar year 2016, taxpayers involved in a corporate transaction in which employers use different measurement methods may rely on the approach described in this notice in determining an employee's status as a full-time employee for purposes of § 4980H. For example, assume that one corporation (Target) merges into another corporation (Acquirer) and that both corporations use the look-back measurement method but with different measurement periods. The corporations may apply the approach set forth in section III of this notice by treating the Target employees as having transferred at the date of the merger from one position (at Target) to another position (at Acquirer) with a different measurement period.

In addition, if a merger, acquisition or similar corporate transaction occurs and, in connection with the corporate transaction, individuals not employed immediately prior to the transaction by an ALE member become employed by that ALE member (new ALE member employees), the ALE member will not be treated as applying an impermissible categorization of employees under § 54.4980H–3(d)(1)(v) merely because it applies during the transition period, to some or all of the new ALE member employees, the measurement method applicable to those employees immediately before the corporate transaction. For this purpose, the transition period is the period beginning on the date of the corporate transaction and ending on the last day of the first stability period following a standard measurement period that would have applied to the new ALE member employees absent the corporate transaction and that begins after the date of such corporate transaction (or, in the case of an ALE member that uses the monthly measurement method with respect to a category of employees, the last day of the first calendar year that begins after the date of the transaction).

Recognizing that the approach described in the immediately preceding paragraphs to addressing the consequences of corporate transactions is not necessarily the only permissible approach and might in some cases present practical issues, the Treasury Department and the IRS encourage comments on this and other possible approaches. As with the other provisons of this notice, nothing in this section of the notice prohibits employers from adopting eligibility provisions that make some employees eligible for coverage in situations in which the employee could potentially be classified as a non-full-time employee under the approach described in this paragraph.

Comments are also requested on whether additional rules are necessary to address situations where an applicable large employer transfers employees to another employment category or to a different ALE member that uses a different look-back measurement method for the purpose of delaying or avoiding the classification of the employee as a full-time employee for § 4980H purposes.

Public comments should be submitted no later than December 29, 2014. Comments should include a reference to Notice 2014–49. Send submissions to CC:PA:LPD:PR (Notice 2014–49), Room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (Notice 2014–49), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC 20044, or sent electronically, via the following e-mail address: *Notice.comments@irscounsel.treas.gov*. Please include "Notice 2014–49" in the subject line of any electronic communication. All material submitted will be available for public inspection and copying.

DRAFTING INFORMATION

The principal author of this notice is Shad C. Fagerland of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). For further information regarding this notice contact Mr. Fagerland at (202) 317-5500 (not a toll-free number).

Notice 2014–54

Guidance on Allocation of After-Tax Amounts to Rollovers

PURPOSE

This notice provides rules for allocating pretax and after-tax amounts among disbursements that are made to multiple destinations from a qualified plan described in § 401(a) of the Internal Revenue Code. These rules also apply to disbursements from a § 403(b) plan or a § 457(b) plan maintained by a governmental employer described in § 457(e)(1)(A) (a "governmental § 457(b) plan"). Section VI of this notice provides transition rules.

BACKGROUND

Section 402(a) provides generally that any amount distributed from a trust described in § 401(a) that is exempt from tax under § 501(a) is taxable to the distributee under § 72 in the taxable year of the distributee in which distributed. Under § 403(b)(1), any amount distributed from a § 403(b) plan is also taxable to the distributee under § 72. (Under § 72(d), a different allocation method applies to annuity distributions.)

If a participant's account balance in a plan qualified under § 401(a) or in a § 403(b) plan includes both after-tax and pretax amounts, then, under § 72(e)(8), each distribution from the account (other than a distribution that is paid as part of an annuity, which is subject to a different rule) will include a pro rata share of both after-tax and pretax amounts.

Under § 402A(d)(4), a designated Roth account in an applicable retirement plan is treated as a separate contract from other amounts in the plan when applying the rules of § 72.

Section 402(c) provides taxability rules for amounts that are rolled over from qualified trusts to eligible retirement plans, including individual retirement accounts or annuities ("IRAs"). Subject to certain exceptions, § 402(c)(1) provides that if any portion of an eligible rollover distribution paid to an employee from a qualified trust is transferred to an eligible retirement plan, the portion of the distribution so transferred is not includible in gross income in the taxable year in which paid.

Under § 402(c)(2), the maximum portion of an eligible rollover distribution that may be rolled over in a transfer to which § 402(c)(1) applies generally cannot exceed the portion of such distribution which is otherwise includible in gross income. However, under § 402(c)(2)(A) and (B), the general rule does not apply to such distribution to the extent that—

(A) such portion is transferred in a direct trustee-to-trustee transfer to a qualified trust or to an annuity contract described in section 403(b) and such trust or contract provides for separate accounting for amounts so transferred (and earnings thereon), including separately accounting for the portion of such distribution which is includible in gross income and the portion of such distribution which is not so includible, or

(B) such portion is transferred to an [IRA].

In addition, § 402(c)(2) provides the following special rule:

> In the case of a transfer described in subparagraph (A) or (B), the amount transferred shall be treated as consisting first of the portion of such distribution that is includible in gross income (determined without regard to [§ 402(c)(1)]).

Under § 402A, an applicable retirement plan, defined in § 402A(e)(1) to include a plan qualified under § 401(a), a § 403(b) plan, or a governmental § 457(b) plan, may include a designated Roth account. Section 402A(d) provides that a qualified distribution (as defined in § 402A(d)(2)) from a designated Roth account is not includible in gross income.

Section 1.402A–1, Q&A–5(a), of the Income Tax Regulations provides taxability rules for a distribution from a designated Roth account that is rolled over. The regulations provide in part that "any amount paid in a direct rollover is treated as a separate distribution from any amount paid directly to the employee."

Section 402(f) requires that the plan administrator of a plan qualified under § 401(a) provide any recipient of an eligible rollover distribution with a written explanation describing certain provisions of law. Notice 2009–68, 2009–2 C.B. 423, provides two safe harbor explanations that may be provided to recipients of eligible rollover distributions from an employer plan in order to satisfy § 402(f). The safe harbor explanation with respect to distributions not from a designated Roth account provides in part (under the heading "If your payment includes after-tax contributions") that "[i]f you do a direct rollover of only a portion of the amount paid from the Plan and a portion is paid to you, each of the payments will include an allocable portion of the after-tax contributions." Similarly, for distributions from a designated Roth account, the safe harbor explanation provides in part (under the heading "How do I do a rollover?") that "[i]f you do a direct rollover of only a portion of the amount paid from the Plan and a portion is paid to you, each of the payments will include an allocable portion of the earnings in your designated Roth account."

Sections 403(b)(8)(B) and 457(e)(16)(B) provide that the rules of § 402(c)(2) through (7), (9), and (11) and the rules of § 402(f) also apply to § 403(b) plans and governmental § 457(b) plans.

In response to Notice 2009–68, comments were received requesting changes to the rules regarding the allocation of basis among simultaneous disbursements to multiple destinations from a retirement plan that contains both after-tax and pretax amounts. Commenters indicated that some plan providers were treating disbursements to separate destinations not as separate distributions but rather as a single distribution of the aggregate disbursement amounts. These plan providers permitted allocation of all the after-tax amounts included in the disbursements to a Roth IRA. The commenters also pointed out that even under the allocation method described in Notice 2009–68 a participant who wishes to disburse after-tax amounts to one destination and pretax amounts to another could accomplish this result in a series of steps. First, the participant could take an eligible rollover distribution as a single cash distribution. Second, by taking advantage of the rule in § 402(c)(2) that distribution amounts that are rolled over are treated as consisting first of pretax amounts, the participant could roll over the pretax amounts included in the distribution to one destination, such as a traditional IRA. The remaining amount of the distribution would be after-tax, which the participant could either roll over into a Roth IRA or retain without incurring any tax liability. The option to roll over all after-tax amounts into a Roth IRA, however, would only be available to taxpayers with sufficient funds available outside of the plan to be able to roll over the entire amount distributed, including the 20 percent of the taxable portion of the distribution paid to the IRS as withholding pursuant to § 3405(c).

As described in section VI of this notice, this notice is being issued in conjunction with proposed regulations that would modify § 1.402A–1, Q&A–5(a).

GUIDANCE ON THE ALLOCATION OF AFTER-TAX AND PRETAX AMOUNTS

For purposes of determining the portion of a disbursement of benefits from a plan to a participant, beneficiary, or alternate payee that is not includible in gross income under the rules of § 72, all disbursements of benefits from the plan to the recipient that are scheduled to be made at the same time (disregarding differences due to reasonable delays to facilitate plan administration) are treated as a single distribution without regard to whether the recipient has directed that the disbursements be made to a single destination or multiple destinations.

If the pretax amount with respect to the aggregated disbursements that are treated as a single distribution is less than the amount of the distribution that is directly rolled over to one or more eligible retirement plans, the entire pretax amount is assigned to the amount of the distribution that is directly rolled over. In such a case, if the direct rollover is to two or more plans, then the recipient can select how the pretax amount is allocated among these plans. To make this selection, the recipient must inform the plan administrator of the allocation prior to the time of the direct rollovers.

If the pretax amount with respect to the aggregated disbursements in a distribution equals or exceeds the amount of the distribution that is directly rolled over to one or more eligible retirement plans, the pretax amount is assigned to the portion of the distribution that is directly rolled over up to the amount of the direct rollover (so that each direct rollover consists entirely of pretax amounts). Any remaining pretax amount is next assigned to any 60-day rollovers (that is, rollovers that are not direct rollovers) up to the amount of the 60-day rollovers. If the remaining pretax amount is less than the amount rolled over in 60-day rollovers, the recipient can select how the pretax amount is allocated among the plans that receive 60-day rollovers.

If, after the assignment of the pretax amount to direct rollovers and 60-day rollovers, there is a remaining pretax amount, that amount is includible in the distributee's gross income. If the amount rolled over to an eligible retirement plan exceeds the portion of the pretax amount assigned or allocated to the plan, the excess is an after-tax amount.

REPORTING REQUIREMENTS

Even though certain multiple disbursements to different destinations are treated as a single aggregated distribution under the first paragraph of section III of this notice, each disbursement may be required to be reported on a separate Form 1099–R, Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc., in accordance with the Instructions to Form 1099–R. In preparing the Form 1099–R, the assignment and allocation rules in section III must be taken into account in determining the amount of pretax contributions assigned or allocated among direct rollovers and any amounts paid to the recipient.

EXAMPLES

Example 1. Employee C participates in a qualified plan that does not contain a designated Roth account. Employee C's $250,000 account balance consists of $200,000 of pretax amounts and $50,000 of after-tax amounts. Employee C separates from service and is entitled to, and requests, a distribution of $100,000. Under § 72(e)(8), the pretax amount with respect to the distribution is $80,000 ($100,000 x $200,000/$250,000). Employee C specifies that $70,000 is to be directly rolled over to the qualified plan maintained by his new employer and that $30,000 is to be paid to Employee C. Because the pretax amount exceeds the amount directly rolled over, the amount directly rolled over to the new plan consists entirely of pretax amounts. The amount paid to Employee C (prior to application of withholding) consists of $10,000 in pretax amounts and $20,000 in after-tax amounts. Prior to the 60th day after the distribution, Employee C chooses to roll over $12,000 to an IRA. Because the amount rolled over in the 60-day rollover exceeds the remaining pretax amounts, the amount rolled over to the IRA consists of $10,000 of pretax amounts and $2,000 of after-tax amounts.

Example 2. The facts are the same as in Example 1, except that Employee C chooses to transfer $82,000 in direct rollovers — $50,000 to the new qualified plan and $32,000 to an IRA. The remaining $18,000 is paid to Employee C. The new qualified plan separately accounts for after-tax contributions. Because the amount rolled over exceeds the pretax amount, the direct rollovers consist of $80,000 in pretax amounts and $2,000 in after-tax amounts. Employee C is permitted to allocate the pretax amounts between the new qualified plan and the IRA prior to the time the direct rollovers are made.

Example 3. The facts are the same as in Example 2, except that the new qualified plan does not separately account for after-tax contributions. In this case, it is impermissible for the $2,000 (which represents the after-tax portion of the distribution) to be rolled over to the new qualified plan. Thus, the entire $50,000 rolled over to the plan must consist of pretax amounts. The $32,000 rolled over to the IRA consists of $30,000 of pretax amounts and $2,000 of after-tax amounts.

Example 4. The facts are the same as in Example 1, except that Employee C chooses to make a direct rollover of $80,000 to a traditional IRA and $20,000 to a Roth IRA. Employee C is permitted to allocate the $80,000 that consists entirely of pretax amounts to the traditional IRA so that the $20,000 rolled over to the Roth IRA consists entirely of after-tax amounts.

PROPOSED REGULATIONS AND TRANSITION RULES

The allocation rules of section III of this notice generally apply to distributions made on or after January 1, 2015.

Concurrent with this notice, the Federal Register has filed for public inspection proposed regulations under § 402A (REG–105739–11, filed for public inspection by the Federal Register on September 18, 2014). The proposed regulations would limit the applicability of the requirement in § 1.402A–1, Q&A–5(a), applicable to distributions from designated Roth accounts that "any amount paid in a direct rollover is treated as a separate distribution from any amount paid directly to the employee." Under the proposed regulations, that separate distribution requirement would not apply to distributions made on or after the applicability date of the Treasury decision finalizing the proposed regulations. The applicability date of the regulations is proposed to be January 1, 2015. However, in accordance with § 7805(b)(7), taxpayers are permitted to apply the proposed regulations to distributions made before the applicability date, so long as such earlier distributions are made on or after September 18, 2014**.** For distributions from designated Roth accounts, the allocation rules of section III of this notice will apply to distributions made on or after the applicability date.

For distributions made on or after September 18, 2014 but before the allocation rules of section III of this notice apply, taxpayers may apply a reasonable interpretation of the last sentence of § 402(c)(2) to allocate after-tax and pretax amounts among disbursements made to multiple destinations. In the case of such disbursements, a reasonable interpretation of the last sentence of § 402(c)(2) includes utilizing the separate distribution allocation rule described in § 1.402A–1, Q&A–5(a). For example, it would be reasonable for a plan administrator to treat each disbursement as a separate distribution that receives a pro rata share of pretax amounts and for the recipient to determine taxability in accordance with that allocation. It would also be reasonable for the plan administrator to allocate pretax amounts in the manner described in section III of this notice as timely selected by the recipient of disbursements made to multiple destinations. In addition, it would be reasonable for a plan administrator to switch from allocating pretax amounts using the separate distribution allocation rule to allocating pretax amounts in the manner described in section III of this notice as timely selected by the recipient.

For distributions made prior to September 18, 2014**,** taxpayers may generally apply the same reasonable interpretation standard described in the preceding paragraph. However, if such a distribution is made from a designated Roth account, the allocation of the pretax amounts must be made in accordance with the rules set forth in the § 402A regulations that were in effect on the date of the distribution.

The IRS also intends to revise the safe harbor explanations that may be provided to recipients of eligible rollover distributions from an employer plan in order to satisfy § 402(f) to reflect this revised method for applying the last sentence of § 402(c)(2).

DRAFTING INFORMATION

The principal author of this notice is Kathleen Herrmann of the Employee Plans, Tax Exempt and Government Entities Division. Questions regarding this notice may be sent via e-mail to *RetirementPlanQuestions@irs.gov*.

Additional Permitted Election Changes for Health Coverage under § 125 Cafeteria Plans

Notice 2014–55

PURPOSE

This notice expands the application of the permitted change rules for health coverage under a § 125 cafeteria plan (cafeteria plan). In particular, this notice addresses two specific situations in which a cafeteria plan participant may wish to revoke, during a period of coverage (commonly a plan year), the employee's election for employer-sponsored health coverage under the cafeteria plan in order to purchase a Qualified Health Plan through a competitive marketplace established under § 1311 of the Patient Protection and Affordable Care Act, commonly referred to as an Exchange or a Health Insurance Marketplace (Marketplace). The first situation involves a participating employee whose hours of service are reduced so that the employee is expected to average less than 30 hours of service per week but for whom the reduction does not affect the eligibility for coverage under the employer's group health plan. (This may occur, for example, under certain employer plan designs intended to avoid any potential assessable payment under § 4980H of the Internal Revenue Code.) The second situation involves an employee participating in an employer's group health plan who would like to cease coverage under the group health plan and purchase coverage through a Marketplace without that resulting either in a period of duplicate coverage under the employer's group health plan and the coverage purchased through a Marketplace or in a period of no coverage.

This notice permits a cafeteria plan to allow an employee to revoke his or her election under the cafeteria plan for coverage under the employer's group health plan (other than a flexible spending arrangement (FSA)) during a period of coverage in each of those situations provided specified conditions are met. The Treasury Department and the IRS intend to modify the regulations under § 125 consistent with the provisions of this notice, but taxpayers may rely on this notice immediately.

BACKGROUND

Section 125(d)(1) defines a cafeteria plan as a written plan maintained by an employer under which all participants are employees, and all participants may choose among two or more benefits consisting of cash and qualified benefits. Section 125(f) defines a qualified benefit as any benefit which, with the application of § 125(a), is not includable in the gross income of the employee by reason of an express provision of the Code (with certain exceptions). Qualified benefits include employer-provided accident and health plans excludable from gross income under §§ 106 and 105(b), but exclude long term care insurance and certain Qualified Health Plans offered through Marketplaces.

Proposed § 1.125–1(c)(1)(iii) of the Income Tax Regulations, consistent with longstanding rules for cafeteria plans, states that a written cafeteria plan must provide that elections are irrevocable except to the extent that the optional change in status rules in Treas. Reg. § 1.125–4 have been included in the cafeteria plan. Treas. Reg. § 1.125–4 provides rules on the circumstances in which a cafeteria plan may permit changes to elections under the plan. Cafeteria plans are not required to allow any of the changes permitted under Treas. Reg. § 1.125–4.

Treas. Reg. § 1.125–4(c) permits a cafeteria plan to allow an employee to revoke an election during a period of coverage with respect to coverage under an accident or health plan as defined in Treas. Reg. § 1.105–5, and make a new election for the remaining portion of the period, if under the facts and circumstances (i) a change in status occurs, and (ii) the election change satisfies the consistency requirements of Treas. Reg. § 1.125–4(c)(3). A change of status for this purpose includes changes in employment status as described in Treas. Reg. § 1.125–4(c)(2)(iii). A change in employment status for this purpose only includes a change in an individual's employment status that results in a change in the individual's eligibility for coverage under the group health plan. Thus, under the existing regulations, a change in employment status that does not result in an employee either becoming or ceasing to be eligible for coverage under the group health plan is not a change in status for which a plan may allow the employee to revoke an election of health coverage under the cafeteria plan during a period of coverage.

Even if the change in status results in a change in eligibility for coverage under the group health plan, any revocation of an election must meet the consistency requirements of Treas. Reg. §§ 1.125–4(c)(3)(i) and 1.125–4(c)(3)(iii). Those requirements provide that if an employee's change in status only results in some of the individuals covered by a group health plan due to their relationship to the employee ceasing to satisfy eligibility requirements for coverage, the employee's election under the cafeteria plan to cancel coverage under the group health plan for any individual other than the individuals losing eligibility fails to correspond with that change in status. Similarly, if a change in status results in an individual gaining eligibility for coverage under a group health plan, an employee's election to cease or decrease coverage for that individual under the cafeteria plan corresponds with the change in status only if the individual enrolls in the coverage for which the individual is newly eligible. That is, an individual gaining eligibility for coverage under a group health plan cannot use that change in status to revoke coverage.

Treas. Reg. § 1.125–4(b) permits a cafeteria plan to allow an employee to revoke an election under the group health plan during a period of coverage and to make a new election that corresponds with the special enrollment rights under § 9801(f). Special enrollment rights under § 9801(f) concern rights to enroll in a group health plan due to loss of other coverage or certain family events, but do not include the ability to enroll in a Qualified Health Plan through a Marketplace.

Interaction with § 4980H

Under § 4980H, an applicable large employer is subject to an assessable payment if the applicable large employer does not offer minimum essential coverage to its full time employees and one or more full time employees receive the premium tax credit under § 36B. Under Treas. Reg. § 54.4980H–3(d), an applicable large employer may use the look-back measurement method to determine the status of an employee as full-time or not full-time. Under the look-back measurement method, for purposes of § 4980H, an employee determined to be full-time based on hours of service during a measurement period must be treated as a full-time employee during a subsequent stability period, regardless of the employee's hours of service during the stability period. Thus, under the look-back measurement method, an employee could have a change in employment status (for example, a change from a full-time position to a part-time position) resulting in a reduction in hours that does not change the employee's status as a full-time employee for purposes of § 4980H, at least for some period of time. Under certain health plan designs intended to avoid any potential assessable payment under § 4980H by offering coverage to employees for all periods during which the employees are classified as full-time employees for § 4980H purposes, the change in employment status would not result in a change in an employee's eligibility for the group health plan. Because the change in employment status would not result in a change in the employee's eligibility for the group health plan, under Treas. Reg. § 1.125–4(c), the cafeteria plan could not allow the employee to change the employee's election under the cafeteria plan during the period of coverage.

Interaction with Enrollment in a Qualified Health Plan Through a Marketplace

Under the current change in status rules under Treas. Reg. § 1.125–4, a cafeteria plan may not allow an employee to revoke an election under the group health plan during a period of coverage solely to enroll in a Qualified Health Plan through a Marketplace. For an individual enrolled through a cafeteria plan in a group health plan with a calendar plan year, the employee may continue his or her coverage under the plan for the remainder of the plan year and then immediately begin coverage under a Qualified Health Plan purchased through a Marketplace. However, an individual enrolled through a cafeteria plan in a group health plan with a noncalendar plan year might not be able to synchronize the change in coverage to avoid an overlapping period of coverage or a period without coverage because the open enrollment period rules for Marketplaces do not permit the purchase of coverage commencing upon the end of the noncalendar cafeteria plan year.

Also, under Treas. Reg. § 1.125–4(b) a cafeteria plan may allow an employee to revoke an election under a group health plan during a period of coverage and to make a new election that corresponds with special enrollment rights under § 9801(f). Special enrollment rights under § 9801(f) relate only to enrollment in another group health plan, not to enrollment in a Qualified Health Plan offered through a Marketplace. Thus, Treas. Reg. § 1.125–4(b) does not permit a cafeteria plan to allow an employee to revoke an election under a group health plan during a period of coverage and enroll in a Qualified Health Plan offered through a Marketplace as the result of an employee's eligibility to enroll in a Qualified Health Plan during Special Enrollment Period for the Marketplace[1] (even though most of the events giving rise to special enrollment rights under § 9801(f) correspond to the events giving

[1]Marketplaces must provide Special Enrollment Periods during which qualified individuals may enroll in Qualified Health Plans offered through Marketplaces. See 45 CFR 155.420(d).

rise to Special Enrollment Periods for a Qualified Health Plan). However, in the case of an event such as a birth or marriage, it may be more advantageous for some individuals to enroll themselves and their families in a Qualified Health Plan rather than to add family members to an employer's group health plan. To permit access to Qualified Health Plans in these cases, this notice permits a cafeteria plan to allow a participating employee to revoke an election in order to obtain coverage through a Marketplace.

GUIDANCE

A cafeteria plan may allow an employee to prospectively revoke an election of coverage under a group health plan that is not a health FSA and that provides minimum essential coverage (as defined in § 5000A(f)(1)) provided the following conditions are met:

Conditions for revocation due to reduction in hours of service

(1) The employee has been in an employment status under which the employee was reasonably expected to average at least 30 hours of service per week and there is a change in that employee's status so that the employee will reasonably be expected to average less than 30 hours of service per week after the change, even if that reduction does not result in the employee ceasing to be eligible under the group health plan; and

(2) The revocation of the election of coverage under the group health plan corresponds to the intended enrollment of the employee, and any related individuals who cease coverage due to the revocation, in another plan that provides minimum essential coverage with the new coverage effective no later than the first day of the second month following the month that includes the date the original coverage is revoked.

A cafeteria plan may rely on the reasonable representation of an employee who is reasonably expected to have an average of less than 30 hours of service per week for future periods that the employee and related individuals have enrolled or intend to enroll in another plan that provides minimum essential coverage for new coverage that is effective no later than the first day of the second month following the month that includes the date the original coverage is revoked.

Conditions for revocation due to enrollment in a Qualified Health Plan

(1) The employee is eligible for a Special Enrollment Period to enroll in a Qualified Health Plan through a Marketplace pursuant to guidance issued by the Department of Health and Human Services and any other applicable guidance, or the employee seeks to enroll in a Qualified Health Plan through a Marketplace during the Marketplace's annual open enrollment period; and

(2) The revocation of the election of coverage under the group health plan corresponds to the intended enrollment of the employee and any related individuals who cease coverage due to the revocation in a Qualified Health Plan through a Marketplace for new coverage that is effective beginning no later than the day immediately following the last day of the original coverage that is revoked.

A cafeteria plan may rely on the reasonable representation of an employee who has an enrollment opportunity for a Qualified Health Plan through a Marketplace that the employee and related individuals have enrolled or intend to enroll in a Qualified Health Plan for new coverage that is effective beginning no later than the day immediately following the last day of the original coverage that is revoked.

EFFECTIVE DATE AND PLAN AMENDMENTS

The guidance in this notice is effective on September 18, 2014. The Treasury Department and the IRS intend to amend Treas. Reg. § 1.125–4 to reflect the guidance in this notice. Taxpayers may rely on the guidance in this notice pending further guidance.

To allow the new permitted election changes under this notice, a cafeteria plan must be amended to provide for such election changes. The amendment must be adopted on or before the last day of the plan year in which the elections are allowed, and may be effective retroactively to the first day of that plan year, provided that the cafeteria plan operates in accordance with the guidance under this notice and the employer informs participants of the amendment, and provided further that a cafeteria plan may be amended to adopt the new permitted election changes for a plan year that begins in 2014 at any time on or before the last day of the plan year that begins in 2015. However, in no event may an election to revoke coverage on a retroactive basis be allowed.

DRAFTING INFORMATION

The principal author of this notice is R. Lisa Mojiri-Azad of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). For further information regarding the clarification in this notice, contact Ms. Mojiri-Azad at (202) 317-5500 (not a toll free number).

Sections 4375 & 4376 — Insured and Self-Insured Health Plans Adjusted Applicable Dollar Amount for Fee Imposed by §§ 4375 and 4376

Notice 2014–56

PURPOSE

This notice provides the adjusted applicable dollar amount to be multiplied by the average number of covered lives for purposes of the fee imposed by §§ 4375 and 4376 of the Internal Revenue Code for policy years and plan years that end on or after October 1, 2014, and before October 1, 2015. This notice also provides that the adjusted applicable dollar amount for policy years and plan years that end on or after October 1, 2015, will be published in guidance of general applicability published in the Internal Revenue Bulletin.

BACKGROUND

Section 4375 imposes a fee on the issuer of a specified health insurance policy for each policy year ending after September 30, 2012, and before October 1, 2019. Section 4376 imposes a fee on the plan sponsor of an applicable self-insured health plan for each plan year ending after September 30, 2012, and before October

1, 2019. The fee imposed by §§ 4375 and 4376 helps to fund the Patient-Centered Outcomes Research Institute (PCORI) and is calculated using the average number of lives covered under the policy or plan and the applicable dollar amount for that policy year or plan year. Under §§ 4375(a) and 4376(a), the applicable dollar amount is $2 for policy and plan years ending on or after October 1, 2013, and before October 1, 2014.[1] Treas. Reg. §§ 46.4375–1(c)(4) and 46.4376–1(c)(3).

Under §§ 4375(d) and 4376(d) and Treas. Reg. §§ 46.4375–1(c)(4) and 46.4376–1(c)(3), the applicable dollar amount for policy years and plan years ending in any Federal fiscal year beginning on or after October 1, 2014 is increased based on increases in the projected per capita amount of National Health Expenditures. Specifically, the applicable dollar amount is the sum of –

(i) The applicable dollar amount for the policy year or plan year ending in the previous Federal fiscal year; plus

(ii) The amount equal to the product of –

(A) The applicable dollar amount for the policy year or plan year ending in the previous Federal fiscal year; and

(B)The percentage increase in the projected per capita amount of the National Health Expenditures most recently released by the Department of Health and Human Services (HHS) before the beginning of the Federal fiscal year.

Based on the percentage increase in the projected per capita amount of the National Health Expenditures published by HHS on September 3, 2014, the applicable dollar amount that must be used to calculate the fee imposed by §§ 4375 and 4376 for policy years and plan years that end on or after October 1, 2014, and before October 1, 2015, is $2.08. See *www.cms.gov/Research-Statistics-Data-and-Systems/Statistics-Trends-and-Reports/NationalHealthExpendData/Downloads/Proj2013tables.zip*, Table 3.

ADJUSTED APPLICABLE DOLLAR AMOUNT

For policy years and plan years ending on or after October 1, 2014, and before October 1, 2015, the adjusted applicable dollar amount is $2.08.

For policy years and plan years ending on or after October 1, 2015, and before October 1, 2019, the adjusted applicable dollar amount will be published in guidance of general applicability published in the Internal Revenue Bulletin.

I. EFFECTIVE DATE

This notice is effective for policy years and plan years ending on or after October 1, 2014.

II. DRAFTING INFORMATION

The principal author of this notice is R. Lisa Mojiri-Azad of the Office of Associate Chief Counsel (Tax Exempt & Government Entities). For further information regarding this notice, contact Ms. Mojiri-Azad at (202) 317-5500 (not a toll free number).

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26 CFR 601.204: Changes in accounting periods and in methods of accounting.
(Also Part I, §§ 168, 446, 481; 1.168(i)–1, 1.168(i)–7, 1.168(i)–8, 1.446–1.)

Rev. Proc. 2014–54

SECTION 1. PURPOSE

This revenue procedure modifies the procedures in Rev. Proc. 2011–14, 2011–4 I.R.B. 330, and Rev. Proc. 2014–17, 2014–12 I.R.B. 661, regarding certain changes in method of accounting for dispositions of tangible depreciable property. This revenue procedure provides the procedures by which a taxpayer may obtain the automatic consent of the Commissioner of Internal Revenue to change to the methods of accounting provided in §§ 1.168(i)–1, 1.168(i)–7, and 1.168(i)–8 of the Income Tax Regulations. This revenue procedure also allows a late partial disposition election under § 1.168(i)–8 to be treated as a change in method of accounting for a limited period of time. Finally, this revenue procedure also modifies section 10.11 of the APPENDIX of Rev. Proc. 2011–14 regarding a change to the method of accounting described in Rev. Proc. 2014–16, 2014–9 I.R.B. 606, for amounts paid to acquire, produce, or improve tangible property.

SECTION 2. BACKGROUND

.01 The Internal Revenue Service (IRS) and the Treasury Department recently issued final regulations under §§ 1.168(i)–1, 1.168(i)–7, and 1.168(i)–8 (T.D. 9689, 2014–36 I.R.B. 456, 79 Fed. Reg. 48661) (the final regulations). Section 1.168(i)–1 provides rules for general asset accounts. Section 1.168(i)–7 provides rules for accounting for property depreciated under § 168 of the Internal Revenue Code (MACRS property). Section 1.168(i)–8 provides rules for dispositions of MACRS property. The final regulations apply to taxable years beginning on or after January 1, 2014, but also permit a taxpayer to choose to apply the final regulations to taxable years beginning on or after January 1, 2012. Alternatively, the final regulations permit a taxpayer to apply the temporary regulations under §§ 1.168(i)–1T, 1.168(i)–7T, and 1.168(i)–8T (T.D. 9564, 2012–14 I.R.B. 614, 76 Fed. Reg. 81060) to, or to rely on the proposed regulations under §§ 1.168(i)–1, 1.168(i)–7, and 1.168(i)–8 (REG–110732–13, 2013–43 I.R.B. 404, 78 Fed. Reg. 57547) for, taxable years beginning on or after January 1, 2012, and beginning before January 1, 2014.

.02 Except as otherwise expressly provided by the Code or the regulations thereunder, § 446(e) and § 1.446–1(e)(2) require a taxpayer to secure the consent of the Commissioner before changing a method of accounting for federal income tax purposes.

.03 Section 1.446–1(e)(2)(ii)(*d*) provides the changes in depreciation or amortization that are changes in a method of accounting and the changes in depreciation or amortization that are not changes in a method of accounting. For changes in a method of accounting under § 1.446–1(e)(2)(ii)(*d*) the item being changed generally is the depreciation treatment of each individual depreciable or amortizable asset. However, for a depreciable asset for which the taxpayer has elected general asset account treatment under § 168(i)(4),

[1]The applicable dollar amount is $1 for policy and plan years ending before October 1, 2013.

the item is the depreciation treatment of each general asset account.

.04 Section 1.446–1(e)(2)(ii)(*d*)(*2*) provides, in relevant part, that each of the following changes in depreciation or amortization is a change in method of accounting:

(1) A change in the depreciation method or amortization method, period of recovery, or convention of a depreciable or amortizable asset;

(2) A change in the accounting for depreciable or amortizable assets from a single asset account to a multiple asset account (pooling), or vice versa, or from one type of multiple asset account (pooling) to a different type of multiple asset account (pooling);

(3) For depreciable or amortizable assets that are mass assets accounted for in multiple asset accounts or pools, a change in the method of identifying which assets have been disposed of; and

(4) Any other change in depreciation or amortization as the Secretary may designate by publication in the Federal Register or in the Internal Revenue Bulletin.

.05 Section 1.446–1(e)(2)(ii)(*d*)(*3*) provides, in relevant part, that none of the following changes in depreciation or amortization is a change in method of accounting:

(1) An adjustment in the useful life of a depreciable or amortizable asset for which depreciation is determined under § 167 (other than under § 168, § 1400I, § 1400L(c), former § 168, or an additional first year depreciation deduction provision of the Code (for example, § 168(k), § 1400L(b), or § 1400N(d))). However, if a taxpayer is changing to or from a useful life (or recovery period or amortization period) that is specifically assigned by the Code (for example, § 167(f)(1), § 168(c), § 168(g)(2), § 168(g)(3), or § 197), the regulations thereunder, or other guidance published in the Internal Revenue Bulletin, such a change is a change in method of accounting;

(2) The making of a late depreciation or amortization election or the revocation of a timely valid depreciation or amortization election, except as otherwise expressly provided by the Code, the regulations thereunder, or other guidance published in the Internal Revenue Bulletin;

(3) Any change in the placed-in-service date of a depreciable or amortizable asset, except as otherwise expressly provided by the Code, the regulations thereunder, or other guidance published in the Internal Revenue Bulletin; and

(4) Any other change in depreciation or amortization as the Secretary may designate by publication in the Federal Register or in the Internal Revenue Bulletin.

.06 Section 1.446–1(e)(2)(ii)(*d*)(*5*)(*iii*) provides that except as otherwise expressly provided by the Code, the regulations thereunder, or other guidance published in the Internal Revenue Bulletin, no § 481(a) adjustment is required or permitted for a change from one permissible method of computing depreciation or amortization to another permissible method of computing depreciation or amortization for an asset. Instead, this change is implemented by either a cut-off method (see section 2.06 of Rev. Proc. 2011–14, 2011–4 I.R.B. at 338) or a modified cut-off method, as appropriate. Under the modified cut-off method, the adjusted depreciable basis of the asset as of the beginning of the year of change is recovered using the new permissible method of accounting. Section 1.446–1(e)(2)(ii)(*d*)(*5*)(*iii*) also provides that a change from an impermissible method of computing depreciation or amortization to a permissible method of computing depreciation or amortization for an asset results in a § 481 adjustment.

.07 Section 1.446–1(e)(3)(ii) authorizes the Commissioner to prescribe administrative procedures setting forth the terms and conditions necessary for a taxpayer to obtain consent to change a method of accounting. Rev. Proc. 2011–14 provides the procedures by which a taxpayer may obtain automatic consent of the Commissioner to change to a method of accounting described in the APPENDIX of Rev. Proc. 2011–14.

.08 Section 3.02 of this revenue procedure modifies the APPENDIX of Rev. Proc. 2011–14 by: (1) removing section 6.19 (lessor improvements abandoned at termination of lease) because it is obsolete; (2) revising section 6.29 (disposition of a building or structural component) to provide that such section does not apply to any demolition of a structure to which § 280B and § 1.280B–1 apply; (3) revising sections 6.32 (general asset account elections), 6.34 (revocation of a general asset account election), and 6.35 (partial dispositions of tangible depreciable assets to which the IRS's adjustment pertains) to allow these changes in method of accounting to be made under § 1.168(i)–1 or § 1.168(i)–8; (4) revising section 6.33 (late partial disposition election) to allow a late partial disposition election under § 1.168(i)–8 to be treated as a change in method of accounting for a limited period of time; (5) revising section 6.37 (permissible to permissible method of accounting for depreciation of MACRS property) to provide additional changes in method of accounting that are consistent with § 1.168(i)–1 or § 1.168(i)–8; and (6) revising section 10.11 (tangible property) to clarify that this section of the APPENDIX does not apply to amounts paid or incurred for certain materials and supplies that the taxpayer has elected to capitalize and depreciate under § 1.162–3(d) or § 1.162–3T(d).

.09 Section 3.03 of this revenue procedure also modifies the APPENDIX of Rev. Proc. 2011–14 by adding sections 6.38 through 6.40 to the APPENDIX to provide additional changes in method of accounting that are consistent with § 1.168(i)–1 or § 1.168(i)–8.

.10 Section 4 of this revenue procedure provides charts that summarize the changes in methods of accounting that may be made under Rev. Proc. 2011–14 for dispositions of MACRS property.

SECTION 3. CHANGES IN METHODS OF ACCOUNTING

.01 *In general*.

(1) Except as provided in section 3.01(2) of this revenue procedure and in § 1.446–1(e)(2)(ii)(*d*)(*3*)(*iii*) (the making of a late depreciation or amortization election or the revocation of a timely valid depreciation or amortization election), a change to comply with § 1.168(i)–1, § 1.168(i)–7, or § 1.168(i)–8 is a change in method of accounting to which § 446(e) applies. *See* § 1.168(i)–1(m)(5), § 1.168(i)–7(e)(5), and § 1.168(i)–8(j)(5). A taxpayer that wants to change to a method of accounting described in section 3.03 of this revenue procedure must use the automatic change in method of ac-

counting provisions in Rev. Proc. 2011–14, as modified by this revenue procedure.

(2) If a taxpayer placed in service assets in a taxable year ending before December 30, 2003 (pre-2003 assets), the taxpayer may treat the change to comply with § 1.168(i)–1, § 1.168(i)–7, or § 1.168(i)–8 for all, or some, of the pre-2003 assets as not a change in method of accounting. In this situation, the taxpayer should file amended federal tax returns for the placed-in-service year of the pre-2003 asset and all subsequent taxable years, limited to the taxable years open under the period of limitation for assessment, to implement the change to comply with § 1.168(i)–1, § 1.168(i)–7, or § 1.168(i)–8 for these pre-2003 assets. If the taxpayer files such amended federal tax returns for the pre-2003 assets, neither an adjustment under § 481 or a similar cumulative depreciation adjustment is required or permitted.

.02 *Modifications to existing automatic changes*.

(1) Section 6.19 of the APPENDIX of Rev. Proc. 2011–14 is modified to read as follows:

6.19 *Reserved*.

(2) Section 6.29(1)(b) of the APPENDIX of Rev. Proc. 2011–14 is modified to read as follows:

(b) *Inapplicability*. This change does not apply to the following:

(i) A taxpayer making this change for any taxable year beginning before January 1, 2012, or beginning on or after January 1, 2014;

(ii) Any property (or if applicable, a portion thereof) that is not depreciated under § 168 under the taxpayer's present method of accounting and, if applicable, under the taxpayer's proposed method of accounting;

(iii) Any property subject to a general asset account election under § 168(i)(4) and the regulations thereunder (but see section 6.31 of this APPENDIX for making a change for dispositions of tangible depreciable assets subject to a general asset account election);

(iv) Any multiple buildings, condominium units, or cooperative units that are treated as a single building under the taxpayer's present method of accounting, or will be treated as a single building under the taxpayer's proposed method of accounting, pursuant to § 1.1250–1(a)(2)(ii);

(v) Any disposition of a portion of an asset for which a partial disposition election under Prop. Reg. § 1.168(i)–8(d)(2) is required but for which the taxpayer did not make such election in accordance with Prop. Reg. § 1.168(i)–8(d)(2)(ii) or (iii), as applicable (but see section 6.33 of this APPENDIX for making a late partial disposition election and section 6.35 of this APPENDIX for making a partial disposition election pursuant to Prop. Reg. § 1.168(i)–8(d)(2)(iii)); or

(vi) Any demolition of a structure to which § 280B and § 1.280B–1 apply.

(3) Section 6.32 of the APPENDIX of Rev. Proc. 2011–14 is modified to read as follows:

6.32 *General asset account elections (section 168(i)(4); § 1.168(i)–1; § 1.168(i)–1T, and Prop. Reg. § 1.168(i)–1)*.

(1) *Description of change*.

(a) *Applicability*. This change, as described in Rev. Proc. 2014–54, 2014–41 I.R.B., applies to a taxpayer that wants to make:

(i) A late general asset account election under § 168(i)(4) and § 1.168(i)–1, § 1.168(i)–1T, or Prop. Reg. § 1.168(i)–1, for one or more items of property depreciated under § 168 (MACRS property) that is placed in service by the taxpayer in a taxable year beginning before January 1, 2012, and owned by the taxpayer at the beginning of the year of change. This change also may affect whether the taxpayer must capitalize amounts paid to restore a unit of property (as determined under § 1.263(a)–3T(e) or (f), or § 1.263(a)–3(e) or (f), as applicable) under § 1.263(a)–3T(i) or § 1.263(a)–3(k), as applicable;

(ii) A late election to recognize gain or loss upon the disposition of all of the assets, or the last asset, in a general asset account in accordance with § 1.168(i)–1T(e)(3)(ii). This change also may affect whether the taxpayer must capitalize amounts paid to restore a unit of property (as determined under § 1.263(a)–3T(e) or (f), or § 1.263(a)–3(e) or (f), as applicable) under § 1.263(a)–3T(i) or § 1.263(a)–3(k), as applicable;

(iii) A late election to recognize gain or loss upon the disposition of all of the assets, the last asset, or the remaining portion of the last asset, in a general asset account in accordance with § 1.168(i)–1(e)(3)(ii) or Prop. Reg. § 1.168(i)–1(e)(3)(ii), as applicable. This change also may affect whether the taxpayer must capitalize amounts paid to restore a unit of property (as determined under § 1.263(a)–3T(e) or (f), or § 1.263(a)–3(e) or (f), as applicable) under § 1.263(a)–3T(i) or § 1.263(a)–3(k), as applicable;

(iv) For an item of MACRS property subject to a general asset account election, a late election to recognize gain or loss upon the disposition of that item in a qualifying disposition (as defined in § 1.168(i)–1T(e)(3)(iii)(B)) in accordance with § 1.168(i)–1T(e)(3)(iii). This change also may affect whether the taxpayer must capitalize amounts paid to restore a unit of property (as determined under § 1.263(a)–3T(e) or (f), or § 1.263(a)–3(e) or (f), as applicable) under § 1.263(a)–3T(i) or § 1.263(a)–3(k), as applicable; or

(v) For an item of MACRS property subject to a general asset account election, a late election to recognize gain or loss upon the disposition of that item in a qualifying disposition (as defined in § 1.168(i)–1(e)(3)(iii)(B) or Prop. Reg. § 1.168(i)–1(e)(3)(iii)(B), as applicable) in accordance with § 1.168(i)–1(e)(3)(iii) or Prop. Reg. § 1.168(i)–1(e)(3)(iii), as applicable. This change also may affect whether the taxpayer must capitalize amounts paid to restore a unit of property (as determined under § 1.263(a)–3T(e) or (f), or § 1.263(a)–3(e) or (f), as applicable) under § 1.263(a)–3T(i) or § 1.263(a)–3(k), as applicable.

(b) *Inapplicability*. Because of the changes made to the general asset account temporary regulations (§ 1.168(i)–1T) by § 1.168(i)–1, the IRS will treat the making of the late elections specified in section 6.32(1)(a) of this APPENDIX as a change in method of accounting only for the time specified in section 6.32(2) of this APPENDIX. Accordingly, this treatment does not apply to a taxpayer that makes any election specified in section 6.32(1)(a) of this APPENDIX before or after the time specified in section 6.32(2) of this APPENDIX, and any such election is not a change in method of accounting pursuant to § 1.446–1(e)(2)(ii)(*d*)(*3*)(*iii*).

(2) *Time for making the change*. The change under section 6.32 of this APPENDIX must be made for any taxable year beginning on or after January 1, 2012, and beginning before January 1, 2014.

(3) *Scope limitations inapplicable*.

(a) *In general*. The scope limitations in section 4.02 of this revenue procedure do not apply to this change.

(b) *Concurrent automatic change*. If a taxpayer makes both a change under this section of this APPENDIX and a change under section 6.01 of this APPENDIX for any taxable year beginning on or after January 1, 2012, and beginning before January 1, 2014, on a single Form 3115 for the same asset for the same year of change in accordance with section 6.32(6)(b) of this APPENDIX, the scope limitations in section 4.02 of this revenue procedure do not apply to the taxpayer for either change.

(4) *Audit protection limited*. If a method of accounting to be changed is (a) an issue pending for any taxable year under examination, (b) an issue under consideration by an appeals office, or (c) an issue under consideration by a federal court, the taxpayer does not receive audit protection under section 7 of this revenue procedure in connection with that change. *See* sections 6.03(6), 6.04, and 6.05 of this revenue procedure.

(5) *Manner of making change*.

(a) The change specified in section 6.32(1)(a)(i) of this APPENDIX is made using a modified cut-off method under which the unadjusted depreciable basis and the depreciation reserve of the asset as of the beginning of the year of change are accounted for using the new method of accounting. This change requires the general asset account to include a beginning balance for both the unadjusted depreciable basis and the depreciation reserve. The beginning balance for the unadjusted depreciable basis of each general asset account is equal to the sum of the unadjusted depreciable bases as of the beginning of the year of change for all assets included in that general asset account. The beginning balance of the depreciation reserve of each general asset account is equal to the sum of the greater of the depreciation allowed or allowable as of the beginning of the year of change for all assets included in that general asset account.

(b) The change specified in section 6.32(1)(a)(ii), (iii), (iv), or (v) of this APPENDIX is made with a § 481(a) adjustment.

(c) A taxpayer whose average annual gross receipts, as determined under § 1.263(a)–3(h)(3), for the three preceding taxable years is less than or equal to $10,000,000 ("qualifying taxpayer") is required to complete only the following information on Form 3115:

(i) The identification section of page 1 (above Part I);

(ii) The signature section at the bottom of page 1;

(iii) Part I, line 1(a);

(iv) Part II, all lines except lines 11, 13, 14, 15, and 17;

(v) Part IV, lines 24, 25, and 26; and

(vi) Schedule E, lines 3, 4a, 4b, and 4c.

(d) A taxpayer (including a qualifying taxpayer) making the change specified in section 6.32(1)(a)(i), (iv), or (v) of this APPENDIX must attach to its Form 3115 a statement with a description of the asset(s) to which this change applies (for example, all 5-year property placed in service in 2009 in Holmdel, New Jersey facility (for a change specified in section 6.32(1)(a)(i) of this APPENDIX) or one desk costing $2,000 in 2007 General Asset Account #1 (for a change specified in section 6.32(1)(a)(iv) of this APPENDIX)).

(e) A taxpayer (including a qualifying taxpayer) making the change specified in section 6.32(1)(a)(ii) or (iii) of this APPENDIX must attach to its Form 3115 a statement with a description of the general asset account(s) to which this change applies (for example, General Asset Account #2 – all 2008 5-year property additions).

(f) A taxpayer (including a qualifying taxpayer) making the change specified in section 6.32(1)(a)(i) of this APPENDIX must attach to its Form 3115 a statement providing that the taxpayer agrees to the following additional terms and conditions:

(i) The taxpayer consents to, and agrees to apply, all of the provisions of [*Insert, as appropriate, either: § 1.168(i)–1, § 1.168(i)–1T, or Prop. Reg. § 1.168(i)–1*] to the assets that are subject to the election specified in section 6.32(1)(a)(i) of this APPENDIX; and

(ii) Except as provided in [*Insert, as appropriate, either: § 1.168(i)–1(c)(1)(iii)(A), (e)(3), (g), or (h), § 1.168(i)–1T(c)(1)(ii)(A), (e)(3), (g), or (h), or Prop. Reg. § 1.168(i)–1(c)(1)(iii)(A), (e)(3), (g), or (h)*], the election made by the taxpayer under section 6.32(1)(a)(i) of this APPENDIX is irrevocable and will be binding on the taxpayer for computing taxable income for the year of change and for all subsequent taxable years with respect to the assets that are subject to this election.

(g) If any asset is public utility property within the meaning of § 168(i)(10), a taxpayer (including a qualifying taxpayer) making this change must attach to its Form 3115 a statement providing that the taxpayer agrees to the following additional terms and conditions:

(i) A normalization method of accounting (within the meaning of § 168(i)(9)) will be used for the public utility property subject to the application;

(ii) Within 30 calendar days of filing the federal income tax return for the year of change, the taxpayer will provide a copy of the completed application to any regulatory body having jurisdiction over the public utility property subject to the application; and

(iii) As of the beginning of the year of change, the taxpayer will adjust its deferred tax reserve account or similar account in the taxpayer's regulatory books of account by the amount of the deferral of federal income tax liability associated with the § 481(a) adjustment applicable to the public utility property subject to the application. This additional term and condition only has to be included in the statement by a taxpayer making the change specified in section 6.32(1)(a)(ii), (iii), (iv), or (v) of this APPENDIX.

(6) *Concurrent automatic change*.

(a) A taxpayer making this change for more than one asset for the same year of change should file a single Form 3115 for all such assets. If the change for more than one asset included in that Form 3115 is specified in section 6.32(1)(a) of this APPENDIX, the single Form 3115 should provide a single net § 481(a) adjustment for all such changes. If one or more of the changes specified in section 6.32(1)(a) of this APPENDIX in that single Form 3115 generate a negative § 481(a) adjustment and other changes specified in section 6.32(1)(a) of this APPENDIX in that same Form 3115 generate a positive § 481(a) adjustment, the taxpayer may provide a single negative § 481(a) adjustment for all such changes that are included in that Form 3115 generating such negative adjustment and a single positive § 481(a) adjustment for all such changes that are included in that Form 3115 generating such positive adjustment.

(b) A taxpayer making a change under section 6.32(1)(a)(ii), (iii), (iv), or (v) of this APPENDIX and any change listed in this section 6.32(6)(b)(i)–(ix) of the APPENDIX for the same year of change should file a single Form 3115 for all such changes and must enter the designated automatic accounting method change numbers for the changes on the appropriate line on the Form 3115. This section 6.32(6)(b) of the APPENDIX applies only if all of these changes are made for any taxable year beginning on or after January 1, 2012, and beginning before January 1, 2014. For guidance on filing a single application for two or more changes, see section 6.02(1)(b)(ii) of this revenue procedure. The listed changes are:

(i) A change under section 6.01 of this APPENDIX;

(ii) A change under section 6.28(3)(b) of this APPENDIX;

(iii) A change under section 6.29 of this APPENDIX;

(iv) A change under section 6.30 of this APPENDIX;

(v) A change under section 6.31 of this APPENDIX;

(vi) A change under section 6.37(4)(b) of this APPENDIX;

(vii) A change under section 6.38 of this APPENDIX;

(viii) A change under section 6.39 of this APPENDIX; and

(ix) A change under section 6.40 of this APPENDIX.

(7) *Ogden copy of Form 3115 required in lieu of national office copy*. A taxpayer changing its method of accounting under this section 6.32 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 6.02(7)(b) (providing the mailing address) of this revenue procedure.

(8) *Designated automatic accounting method change numbers*. The designated automatic accounting method change number for a change to the method of accounting under section 6.32 of this APPENDIX is "180." *See* section 6.02(4) of this revenue procedure.

(9) *Contact information*. For further information regarding a change under this section, contact Patrick Clinton at (202) 317-7005 (not a toll-free call).

(4) Section 6.33 of the APPENDIX of Rev. Proc. 2011–14 is modified to read as follows:

6.33 *Late partial disposition election (section 168; § 1.168(i)–8 and Prop. Reg. § 1.168(i)–8)*.

(1) *Description of change*.

(a) *Applicability*. This change, as described in Rev. Proc. 2014–54, 2014–41 I.R.B., applies to a taxpayer that wants to make a late partial disposition election under § 1.168(i)–8(d)(2)(i) or Prop. Reg. § 1.168(i)–8(d)(2)(i) for the disposition of a portion of an asset (as determined under § 1.168(i)–8(c)(4) or Prop. Reg. § 1.168(i)–8(c)(4), as applicable) by the taxpayer. This change includes the late partial disposition election specified in § 1.168(i)–8(d)(2)(i) that is made pursuant to § 1.168(i)–8(d)(2)(iv)(B) or in Prop. Reg. § 1.168(i)–8(d)(2)(i) that is made pursuant to Prop. Reg. § 1.168(i)–8(d)(2)(iv)(B). This change also may affect whether the taxpayer must capitalize amounts paid to restore a unit of property (as determined under § 1.263(a)–3T(e) or (f), or § 1.263(a)–3(e) or (f), as applicable) under §1.263(a)–3T(i) or § 1.263(a)–3(k), as applicable.

(b) *Inapplicability*. This change does not apply to the following:

(i) A taxpayer making a late partial disposition election under Prop. Reg. § 1.168(i)–8(d)(2)(i) but does not apply all the provisions of Prop. Reg. § 1.168(i)–8;

(ii) Any asset of which the disposed portion was a part that is not owned by the taxpayer at the beginning of the year of change;

(iii) A taxpayer making any late election specified in section 6.33(1)(a) of this APPENDIX after the time specified in section 6.33(3) of this APPENDIX. Any such late election is not a change in method of accounting pursuant to § 1.446–1(e)(2)(ii)(*d*)(*3*)(*iii*); or

(iv) The partial disposition election specified in § 1.168(i)–8(d)(2)(i) that is made pursuant to § 1.168(i)–8(d)(2)(iii) or in Prop. Reg. § 1.168(i)–8(d)(2)(i) that is made pursuant to Prop. Reg. § 1.168(i)–8(d)(2)(iii), as applicable (but see section 6.35 of this APPENDIX for making this change).

(2) *Change in method of accounting*. The IRS will treat the making of the late election specified in section 6.33(1) of this APPENDIX as a change in method of accounting only for the time specified in section 6.33(3) of this APPENDIX.

(3) *Time for making the change*.

(a) If the change under this section 6.33 of the APPENDIX is made pursuant to § 1.168(i)–8(d)(2)(i), this change must be made for any taxable year beginning on or after January 1, 2012, and beginning before January 1, 2015.

(b) If the change under this section 6.33 of the APPENDIX is made pursuant to Prop. Reg. § 1.168(i)–8(d)(2)(i), this change must be made for any taxable year beginning on or after January 1, 2012, and beginning before January 1, 2014.

(c) If the change under this section 6.33 of the APPENDIX is made pursuant to § 1.168(i)–8(d)(2)(iv)(B) or Prop. Reg. § 1.168(i)–8(d)(2)(iv)(B), as applicable, this change must be made for the first or second taxable year succeeding the applicable taxable year (as defined in § 1.168(i)–8(d)(2)(iv) or Prop. Reg. § 1.168(i)–8(d)(2)(iv), as applicable), pursuant to § 1.168(i)–8(d)(2)(iv)(B) or Prop. Reg. § 1.168(i)–8(d)(2)(iv)(B), as applicable.

(4) *Scope limitations inapplicable*.

(a) *In general*. The scope limitations in section 4.02 of this revenue procedure do not apply to this change.

(b) *Concurrent automatic change*. If a taxpayer makes both a change under this section of this APPENDIX and a change under section 6.01 of this APPENDIX for any taxable year specified in section

6.33(3) of this APPENDIX, as applicable, on a single Form 3115 for the same asset for the same year of change in accordance with section 6.33(7)(b) of this APPENDIX, the scope limitations in section 4.02 of this revenue procedure do not apply to the taxpayer for either change.

(5) *Audit protection limited*. If a method of accounting to be changed is (a) an issue pending for any taxable year under examination, (b) an issue under consideration by an appeals office, or (c) an issue under consideration by a federal court, the taxpayer does not receive audit protection under section 7 of this revenue procedure in connection with that change. *See* sections 6.03(6), 6.04, and 6.05 of this revenue procedure.

(6) *Manner of making change*.

(a) A taxpayer whose average annual gross receipts, as determined under § 1.263(a)–3(h)(3), for the three preceding taxable years is less than or equal to $10,000,000 ("qualifying taxpayer") is required to complete only the following information on Form 3115:

(i) The identification section of page 1 (above Part I);

(ii) The signature section at the bottom of page 1;

(iii) Part I, line 1(a);

(iv) Part II, all lines except lines 11, 13, 14, 15, and 17;

(v) Part IV, lines 25 and 26; and

(vi) Schedule E, line 3.

(b) A taxpayer (including a qualifying taxpayer) making this change must:

(i) Apply § 1.168(i)–8(h)(1) and (3) or Prop. Reg. § 1.168(i)–8(h)(1) and (3), as applicable (accounting for asset disposed of);

(ii) If the asset (as determined under § 1.168(i)–8(c)(4) or Prop. Reg. § 1.168(i)–8(c)(4), as applicable) of which the disposed portion is a part is properly included in one of the asset classes 00.11 through 00.4 of Rev. Proc. 87–56, 1987–2 C.B. 674, classify the replacement portion of such asset under the same asset class as the disposed portion of the asset in the taxable year in which the replacement portion is placed in service by the taxpayer;

(iii) If the taxpayer's present method of accounting is not in accord with § 1.168(i)–8(c)(4) or Prop. Reg. § 1.168(i)–8(c)(4), as applicable (determination of asset disposed of), change to the appropriate asset as determined under § 1.168(i)–8(c)(4) or Prop. Reg. § 1.168(i)–8(c)(4), as applicable;

(iv) If the taxpayer continues to deduct depreciation for the disposed portion of the asset (as determined under § 1.168(i)–8(c)(4) or Prop. Reg. § 1.168(i)–8(c)(4), as applicable) under the taxpayer's present method of accounting, change from depreciating such disposed portion to recognizing gain or loss for the disposed portion or, if § 280B and § 1.280B–1 apply to the disposition, change from depreciating such disposed portion to capitalizing the loss sustained on account of the demolition to the land on which the demolished structure was located;

(v) If the taxpayer recognized a gain or loss under § 1.168(i)–1T or § 1.168(i)–8T for the disposed portion of the asset in a taxable year prior to the year of change, recognize gain or loss for such disposed portion under § 1.168(i)–8 or Prop. Reg. § 1.168(i)–8, as applicable; and

(vi) If any asset is public utility property within the meaning of § 168(i)(10), attach to its Form 3115 a statement providing that the taxpayer agrees to the following additional terms and conditions:

(A) A normalization method of accounting (within the meaning of § 168(i)(9)) will be used for the public utility property subject to the application;

(B) Within 30 calendar days of filing the federal income tax return for the year of change, the taxpayer will provide a copy of the completed application to any regulatory body having jurisdiction over the public utility property subject to the application; and

(C) As of the beginning of the year of change, the taxpayer will adjust its deferred tax reserve account or similar account in the taxpayer's regulatory books of account by the amount of the deferral of federal income tax liability associated with the § 481(a) adjustment applicable to the public utility property subject to the application.

(7) *Concurrent automatic change*.

(a) A taxpayer making this change for more than one asset for the same year of change should file a single Form 3115 for all such assets. If the change for more than one asset included in that Form 3115 is specified in section 6.33(1) of this APPENDIX, the single Form 3115 should provide a single net § 481(a) adjustment for all such changes. If one or more of the changes specified in section 6.33(1) of this APPENDIX in that single Form 3115 generate a negative § 481(a) adjustment and other changes specified in section 6.33(1) of this APPENDIX in that same Form 3115 generate a positive § 481(a) adjustment, the taxpayer may provide a single negative § 481(a) adjustment for all such changes that are included in that Form 3115 generating such negative adjustment and a single positive § 481(a) adjustment for all such changes that are included in that Form 3115 generating such positive adjustment.

(b) A taxpayer making this change and any change listed in this section 6.33(7)(b)(i)–(ii) of the APPENDIX for the same year of change should file a single Form 3115 for all such changes and must enter the designated automatic accounting method change numbers for the changes on the appropriate line on the Form 3115. This section 6.33(7)(b) of the APPENDIX applies only if all of these changes are made for any taxable year specified in section 6.33(3) of this APPENDIX, as applicable (for example, for a taxable year beginning on or after January 1, 2012, and beginning before January 1, 2015 if the change under this section 6.33 of the APPENDIX is made pursuant to § 1.168(i)–8(d)(2)(i)). For guidance on filing a single application for two or more changes, see section 6.02(1)(b)(ii) of this revenue procedure. The listed changes are:

(i) A change under section 6.01 of this APPENDIX; and

(ii) A change under section 6.34 of this APPENDIX.

(8) *Examples*. The following examples illustrate the changes that may made be under this section 6.33.

(a) *Example 1*. (i) X, a calendar year taxpayer, acquired and placed in service a truck in 2009. The truck is described in asset class 00.242 of Rev. Proc. 87–56. X depreciates the truck under § 168. X does not reasonably expect to replace the engine of the truck more than once during its class life of 6 years. The engine is a major component of the truck under § 1.263(a)–3T(i)(1)(vi).

(ii) In 2012, X replaced the engine of the truck. X applied § 1.168(i)–8T and § 1.263(a)–3T for its taxable year ended

December 31, 2012. Because the truck is the asset for disposition purposes, X did not recognize a loss on the retirement of the engine under § 1.168(i)–8T and continues to depreciate the original engine. Further, X capitalized the new engine as an improvement, classified the new engine under asset class 00.242 of Rev. Proc. 87–56, and depreciates the new engine under § 168.

(iii) X decides to apply § 1.168(i)–8 beginning with its taxable year ending December 31, 2013. X also decides to make the late partial disposition election under this section 6.33 for the truck's original engine that X retired in 2012. Although the truck is the asset for disposition purposes under § 1.168(i)–8(c)(4)(ii)(C), the partial disposition rule under § 1.168(i)–8(d)(2)(i) results in the retirement of the engine being a disposition under § 1.168(i)–8(b)(2). Thus, in accordance with section 6.33 of this APPENDIX, X may file a Form 3115 with its 2013 federal income tax return to make the late disposition election for the engine and change from depreciating the original engine to recognizing a loss upon its retirement.

(b) *Example 2*. (i) Y, a calendar year taxpayer, acquired and placed in service a building and its structural components in 2000. Y depreciates this building and its structural components under § 168. The roof is a structural component of the building. Y replaced the entire roof in 2010. On its federal income tax return for the taxable year ended December 31, 2010, Y did not recognize a loss on the retirement of the original roof and continued to depreciate the original roof. Y also capitalized the cost of the replacement roof and has been depreciating that roof under § 168 since June 2010. The adjusted depreciable basis of the original roof at the time of its retirement in 2010 (taking into account the applicable convention) is $11,000, and Y claimed depreciation of $1,000 for such roof after its retirement (taking into account the applicable convention) and before the 2012 taxable year.

(ii) In accordance with § 1.168(i)–8T(c)(4)(ii)(A) and (B) and section 6.29(3)(a) and (b) of the APPENDIX to Rev. Proc. 2011–14, as modified by Rev. Proc. 2012–20, 2012–14 I.R.B. 700, Y filed with its federal income tax return for the taxable year ended December 31, 2012, a Form 3115 to treat the building as an asset and each structural component of the building as a separate asset for disposition purposes and also to change from depreciating the original roof to recognizing a loss upon its retirement. The amount of the net negative § 481(a) adjustment on this Form 3115 is $10,000 (adjusted depreciable basis of $11,000 for the original roof at the time of its retirement (taking into account the applicable convention) less depreciation of $1,000 claimed for such roof after its retirement (taking into account the applicable convention) and before the 2012 taxable year).

(iii) Y complies with § 1.168(i)–8 beginning with its taxable year ending December 31, 2014. Y also decides to make the late partial disposition election under this section 6.33 for the building's original roof that Y retired in 2010. Although the original building (including its original roof and other original structural components) is the asset for disposition purposes under § 1.168(i)–8(c)(4)(ii)(A), the partial disposition rule under § 1.168(i)–8(d)(2)(i) results in the retirement of the original roof being a disposition under § 1.168(i)–8(b)(2). Thus, in accordance with section 6.33 of this APPENDIX, Y may file a Form 3115 with its 2014 federal income tax return to make a late partial disposition election for the original roof, treat the original building (including its original roof and other original structural components) as an asset and the replacement roof to the building as a separate asset for disposition purposes, and recognize a loss upon the retirement of the original roof under § 1.168(i)–8.

(iv) The computation of the net § 481 adjustment for this change is computed as follows:

Net loss on retirement of original roof on 2012 return under § 1.168(i)–8T	$10,000
Net loss on retirement of original roof under § 1.168(i)–8	(10,000)
Net § 481(a) adjustment for the roof	$ 0

(9) *Ogden copy of Form 3115 required in lieu of national office copy*. A taxpayer changing its method of accounting under this section 6.33 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 6.02(7)(b) (providing the mailing address) of this revenue procedure.

(10) *Designated automatic accounting method change numbers*. The designated automatic accounting method change number for a change to the method of accounting under section 6.33 of this APPENDIX is "196." *See* section 6.02(4) of this revenue procedure.

(11) *Contact information*. For further information regarding a change under this section, contact Patrick Clinton at (202) 317-7005 (not a toll-free call).

(5) Section 6.34 of the APPENDIX of Rev. Proc. 2011–14 is modified to read as follows:

6.34 *Revocation of a general asset account election (section 168; § 1.168(i)–1, § 1.168(i)–1T, and Prop. Reg. § 1.168(i)–1)*.

(1) *Description of change*.

(a) *Applicability*. This change, as described in Rev. Proc. 2014–54, 2014–41 I.R.B., applies to a taxpayer that wants to revoke its general asset account election:

(i) Made under section 6.32(1)(a)(i) of this APPENDIX for one or more items of property depreciated under § 168 (MACRS property) included in the general asset account. This change also may affect whether the taxpayer must capitalize amounts paid to restore a unit of property (as determined under § 1.263(a)–3T(e) or (f), or § 1.263(a)–3(e) or (f), as applicable) under § 1.263(a)–3T(i) or § 1.263(a)–3(k), as applicable; or

(ii) Made under § 1.168(i)–1, § 1.168(i)–1T, or Prop. Reg. § 1.168(i)–1 for one or more items of MACRS property placed in service by the taxpayer in a taxable year beginning on or after January 1, 2012, and beginning before January 1, 2014. This change also may affect whether the taxpayer must capitalize amounts paid to restore a unit of property (as determined under § 1.263(a)–3T(e) or (f), or § 1.263(a)–3(e) or (f), as applicable) under § 1.263(a)–3T(i) or § 1.263(a)–3(k), as applicable.

(b) *Inapplicability*. Because of the changes made to the general asset account temporary regulations (§ 1.168(i)–1T) by § 1.168(i)–1, the IRS will treat the revocation of the elections specified in section 6.34(1)(a) of this APPENDIX as a change in method of accounting only for the time specified in section 6.34(2) of this APPENDIX. Accordingly, this treatment does not apply to a taxpayer that makes any revocation specified in section 6.34(1)(a) of this APPENDIX before or after the time specified in section 6.34(2) of this APPENDIX. Any such revocation is not a change in method of accounting pursuant to § 1.446–1(e)(2)(ii)(*d*)(*3*)(*iii*). The elections specified in section 6.34(1)(a) of this APPENDIX are irrevocable except as provided in § 1.168(i)–1(c)(1)(ii)(A), (e)(3), (g), or (h), § 1.168(i)–1T(c)(1)(ii)(A), (e)(3), (g), or (h), or Prop. Reg. § 1.168(i)–1(c)(1)(ii)(A), (e)(3), (g), or (h), as applicable.

(2) *Time for making the change*. The change under section 6.34 of this APPENDIX must be made for any taxable year beginning on or after January 1, 2012, and beginning before January 1, 2015.

(3) *Scope limitations inapplicable*.

(a) *In general*. The scope limitations in section 4.02 of this revenue procedure do not apply to this change.

(b) *Concurrent automatic change*. If a taxpayer makes both a change under this section of this APPENDIX and a change under section 6.01 of this APPENDIX for any taxable year beginning on or after January 1, 2012, and beginning before January 1, 2015, on a single Form 3115 for the same asset for the same year of change in accordance with section 6.34(7)(b) of this APPENDIX, the scope limitations in section 4.02 of this revenue procedure do not apply to the taxpayer for either change. If a taxpayer makes both a change under this section of this APPENDIX and a change under section 6.01 of this APPENDIX for any taxable year beginning on or after January 1, 2012, and beginning before January 1, 2014, on a single Form 3115 for the same asset for the same year of change in accordance with section 6.34(7)(c) of this APPENDIX, the scope limitations in section 4.02 of this revenue procedure do not apply to the taxpayer for either change.

(4) *Audit protection limited*. If a method of accounting to be changed is (a) an issue pending for any taxable year under examination, (b) an issue under consideration by an appeals office, or (c) an issue under consideration by a federal court, the taxpayer does not receive audit protection under section 7 of this revenue procedure in connection with that change. *See* sections 6.03(6), 6.04, and 6.05 of this revenue procedure.

(5) *Section 481(a) adjustment period*. A taxpayer making this change must take the entire amount of the § 481(a) adjustment into account in computing taxable income for the year of change.

(6) *Manner of making change*.

(a) A taxpayer whose average annual gross receipts, as determined under § 1.263(a)–3(h)(3), for the three preceding taxable years is less than or equal to $10,000,000 ("qualifying taxpayer") is required to complete only the following information on Form 3115:

(i) The identification section of page 1 (above Part I);

(ii) The signature section at the bottom of page 1;

(iii) Part I, line 1(a);

(iv) Part II, all lines except lines 11, 13, 14, 15, and 17;

(v) Part IV, lines 25 and 26; and

(vi) Schedule E, lines 3, 4a, 4b, and 4c.

(b) A taxpayer (including a qualifying taxpayer) making this change must:

(i) Attach to its Form 3115 a statement with a description of the asset(s) to which this change applies (for example, all general asset accounts established pursuant to a Form 3115 filed under section 6.32(1)(a)(i) of this APPENDIX for the year of change beginning January 1, 2012 (for a change specified in section 6.34(1)(a)(i) of this APPENDIX); one desk costing $2,000 in 2012 General Asset Account #1 (for a change specified in section 6.34(1)(a)(ii) of this APPENDIX));

(ii) Include the asset(s) that were in the general asset account(s) at the end of the taxable year immediately preceding the year of change in a single asset account or a multiple asset account in accordance with § 1.168(i)–7. The single asset account or the multiple asset account must include a beginning balance for both the unadjusted depreciable basis and the depreciation reserve. For a single asset account, the beginning balance for the unadjusted depreciable basis of that single asset account is equal to the unadjusted depreciable basis as of the beginning of the year of change for the asset included in that single asset account and the beginning balance of the depreciation reserve of that single asset account is the greater of the depreciation allowed or allowable as of the beginning of the year of change for the asset included in that single asset account. For a multiple asset account, the beginning balance for the unadjusted depreciable basis of that multiple asset account is equal to the sum of the unadjusted depreciable bases as of the beginning of the year of change for all assets included in that multiple asset account and the beginning balance of the depreciation reserve of that multiple asset account is equal to the sum of the greater of the depreciation allowed or allowable as of the beginning of the year of change for all assets included in that multiple asset account; and

(iii) If any asset is public utility property within the meaning of § 168(i)(10), attach to its Form 3115 a statement providing that the taxpayer agrees to the following additional terms and conditions:

(A) A normalization method of accounting (within the meaning of § 168(i)(9)) will be used for the public utility property subject to the application;

(B) Within 30 calendar days of filing the federal income tax return for the year of change, the taxpayer will provide a copy of the completed application to any regulatory body having jurisdiction over the public utility property subject to the application; and

(C) As of the beginning of the year of change, the taxpayer will adjust its deferred tax reserve account or similar account in the taxpayer's regulatory books of account by the amount of the deferral of federal income tax liability associated with the § 481(a) adjustment applicable to the public utility property subject to the application.

(7) *Concurrent automatic change*.

(a) A taxpayer making this change for more than one asset for the same year of change should file a single Form 3115 for all such assets. If the change for more than one asset included in that Form 3115 is specified in section 6.34(1)(a) of this AP-

PENDIX, the single Form 3115 must provide a single net § 481(a) adjustment for all such changes.

(b) A taxpayer making this change and any change listed in this section 6.34(7)(b)(i)–(iv) of the APPENDIX for the same year of change should file a single Form 3115 for all such changes and must enter the designated automatic accounting method change numbers for the changes on the appropriate line on the Form 3115. This section 6.34(7)(b) of the APPENDIX applies only if all of these changes are made for any taxable year beginning on or after January 1, 2012, and beginning before January 1, 2015. For guidance on filing a single application for two or more changes, see section 6.02(1)(b)(ii) of this revenue procedure. The listed changes are:

(i) A change under section 6.01 of this APPENDIX;

(ii) A change under section 6.33 of this APPENDIX made pursuant to § 1.168(i)–8(d)(2)(i);

(iii) A change under section 6.38 of this APPENDIX; and

(iv) A change under section 6.39 of this APPENDIX.

(c) A taxpayer making this change, any change listed in section 6.34(7)(b)(i), (iii), or (iv) of the APPENDIX, and any change listed in this section 6.34(7)(c)(i)–(iii) of the APPENDIX for the same year of change should file a single Form 3115 for all such changes and must enter the designated automatic accounting method change numbers for the changes on the appropriate line on the Form 3115. This section 6.34(7)(c) of the APPENDIX applies only if all of these changes are made for any taxable year beginning on or after January 1, 2012, and beginning before January 1, 2014. For guidance on filing a single application for two or more changes, see section 6.02(1)(b)(ii) of this revenue procedure. The listed changes are:

(i) A change under section 6.29 of this APPENDIX;

(ii) A change under section 6.30 of this APPENDIX; and

(iii) A change under section 6.33 of this APPENDIX made pursuant to Prop. Reg. § 1.168(i)–8(d)(2)(i).

(8) *Examples*. The following examples illustrate the changes that may made be under this section 6.34.

(a) *Example 1*. (i) On its federal tax return for the taxable year ended December 31, 2012, X made a general asset account election under § 1.168(i)–1T to apply § 1.168(i)–1T to all of its assets placed in service during 2012. No such assets were disposed of during 2012. X decides to apply §§ 1.168(i)–1 and 1.168(i)–8 for its taxable year ending December 31, 2013. Because of the change in the definition of a qualifying disposition under § 1.168(i)–1(e)(3)(iii), X does not want its assets placed in service during 2012 in general asset accounts. In accordance with this section 6.34, X files with its federal tax return for the taxable year ending December 31, 2013, a Form 3115 to revoke the general asset account election for all assets placed in service during 2012 and include such assets in one multiple asset account in accordance with § 1.168(i)–7. Because the adjusted depreciable basis of the assets is not changed as a result of this change, a § 481(a) adjustment is neither required nor permitted.

(b) *Example 2*. (i) Y, a calendar year taxpayer, acquired and placed in service three used trucks in 2011. The trucks are described in asset class 00.242 of Rev. Proc. 87–56, 1987–2 C.B. 674. Of the three trucks, one truck costs $20,000 and the other two trucks cost a total of $30,000. Y depreciates the trucks under § 168. In 2012, Y sold the truck that cost $20,000 to an unrelated party for $12,000. The adjusted depreciable basis of the truck at the time of its disposition (taking into account the applicable convention) is $12,800 (cost of $20,000 less depreciation of $7,200 for 2011 and 2012).

(ii) In accordance with § 1.168(i)–1T and section 6.32(1)(a)(i) of the APPENDIX to Rev. Proc. 2011–14, as modified by Rev. Proc. 2012–20, 2012–14 I.R.B. 700, Y filed with its federal tax return for the taxable year ended December 31, 2012, a Form 3115 to make a late general asset account election to include the three trucks in one general asset account. Because a sales transaction is a qualifying disposition under § 1.168(i)–1T(e)(3)(iii)(B), Y also elected to apply § 1.168(i)–1T(e)(3)(iii) for the sale of the truck in 2012. As a result, Y removed this truck from the general asset account and, on its 2012 federal tax return, recognized a loss of $800 under § 1.168(i)–8T (sales proceeds of $12,000 less the adjusted depreciable basis of $12,800 for the truck).

(iii) Y complies with §§ 1.168(i)–1 and 1.168(i)–8 beginning with its taxable year ending December 31, 2014. Because a sales transaction is not a qualifying disposition under § 1.168(i)–1(e)(3)(iii)(B), Y should have recognized all of the sales proceeds of $12,000 from the sale of the truck in 2012 as ordinary income and continued to deduct depreciation for this truck in the general asset account. As a result and in accordance with sections 6.34 and 6.39(4)(i) of this APPENDIX, Y files with its 2014 federal tax return a Form 3115 to revoke the general asset account election for the three trucks placed in service in 2011, include the two unsold trucks in one multiple asset account in accordance with § 1.168(i)–7, and recognize the loss of $800 upon the sale of the truck in 2012 under § 1.168(i)–8.

(iv) The computation of the § 481 adjustment for this change is computed as follows:

Loss on sale of truck on 2012 return under § 1.168(i)–8T	$ 800
Loss on sale of truck under § 1.168(i)–8	(800)
Net § 481(a) adjustment for the asset	$ 0

(c) *Example 3*. (i) Z, a calendar year taxpayer, acquired and placed in service a building and its structural components in 2000. Z depreciates this building and its structural components under § 168. The roof is a structural component of the building. Z replaced the entire roof in 2010. On its federal tax return for the taxable year ended December 31, 2010, Z did not recognize a loss on the retirement of the original roof and continued to depreciate the original roof. Z also capitalized the cost of the replacement roof and has been depreciating this roof under § 168 since June 2010. The adjusted depreciable basis of the original roof at the time of its retirement in 2010 (taking into account the applicable convention) is $11,000, and Z claimed depreciation of $1,000 for such roof after its retirement (taking into account the applicable convention) and before the 2012 taxable year. Also the 12-month allowable depreciation deduction for the original roof is $500 for the 2012 taxable year.

(ii) In accordance with § 1.168(i)–1T and section 6.32(1)(a) of the APPENDIX to Rev. Proc. 2011–14, as modified by Rev. Proc. 2012–20, 2012–14 I.R.B. 700, Z filed with its federal tax return for the taxable year ended December 31, 2012, a Form 3115 to: (1) make a late general asset account election to include the building (including its structural components) placed in service in 2000 in one general asset account and the replacement roof in a separate general asset account; and (2) make a late qualifying disposition election for the retirement of the original roof in 2010. As a result, Z removed the original roof from the general asset account and reported a net negative § 481(a) adjustment on this Form 3115 of $10,000 (adjusted depreciable basis of $11,000 for the original roof at the time of its retirement (taking into account the applicable convention) less depreciation of $1,000 claimed for such roof after its retirement (taking into account the applicable convention) and before the 2012 taxable year).

(iii) Z decides to apply §§ 1.168(i)–1 and 1.168(i)–8 for its taxable year ending December 31, 2013, but decides not to make any late partial disposition election under section 6.33 of this APPENDIX. In accordance with sections 6.34 and 6.38(4)(a) of this APPENDIX, Z files a Form 3115 with its 2013 federal income tax return to revoke the general asset account election for the building (including its structural components) placed in service in 2000 and for the replacement roof, and to change to treating the building (including its original roof and other original structural components) placed in service in 2000 as an asset and the replacement roof as a separate asset for disposition purposes. The net positive § 481(a) adjustment for this change is $9,500 (net loss of $10,000 claimed on the 2012 return for the retirement of the original roof less depreciation of $500 for the original roof for 2012) and is included in Z's taxable income for 2013.

(9) *Ogden copy of Form 3115 required in lieu of national office copy*. A taxpayer changing its method of accounting under this section 6.34 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 6.02(7)(b) (providing the mailing address) of this revenue procedure.

(10) *Designated automatic accounting method change numbers*. The designated automatic accounting method change number for a change to the method of accounting under section 6.34 of this APPENDIX is "197." *See* section 6.02(4) of this revenue procedure.

(11) *Contact information*. For further information regarding a change under this section, contact Patrick Clinton at (202) 317-7005 (not a toll-free call).

(6) Section 6.35 of the APPENDIX of Rev. Proc. 2011–14 is modified to read as follows:

6.35 *Partial dispositions of tangible depreciable assets to which the IRS's adjustment pertains (section 168; § 1.168(i)–8 and Prop. Reg. § 1.168(i)–8).*

(1) *Description of change*.

(a) *Applicability*. This change, as described in Rev. Proc. 2014–54, 2014–41 I.R.B., applies to a taxpayer that is described in § 1.168(i)–8(d)(2)(iii) or Prop. Reg. § 1.168(i)–8(d)(2)(iii) and, pursuant to § 1.168(i)–8(d)(2)(iii) or Prop. Reg. § 1.168(i)–8(d)(2)(iii), that wants to make the partial disposition election specified in § 1.168(i)–8(d)(2)(i) or Prop. Reg. § 1.168(i)–8(d)(2)(i) to the disposition of a portion of an asset to which the IRS's adjustment (as described in § 1.168(i)–8(d)(2)(iii) or Prop. Reg. § 1.168(i)–8(d)(2)(iii), as applicable) pertains.

(b) *Inapplicability*. This change does not apply to:

(i) Any asset of which the disposed portion was a part that is not owned by the taxpayer at the beginning of the year of change;

(ii) The partial disposition election specified in § 1.168(i)–8(d)(2)(i) that is made pursuant to § 1.168(i)–8(d)(2)(iv) or specified in Prop. Reg. § 1.168(i)–8(d)(2)(i) that is made pursuant to Prop. Reg. § 1.168(i)–8(d)(2)(iv) (but see section 6.33 of this APPENDIX for making this change).

(2) *Change in method of accounting*. The IRS will treat the making of the late election specified in section 6.35(1) of this APPENDIX as a change in method of accounting.

(3) *Scope limitations inapplicable*. The scope limitations in section 4.02 of this revenue procedure do not apply to this change.

(4) *Audit protection limited*. If a method of accounting to be changed is (a) an issue pending for any taxable year under examination, (b) an issue under consideration by an appeals office, or (c) an issue under consideration by a federal court, the taxpayer does not receive audit protection under section 7 of this revenue procedure in connection with that change. *See* sections 6.03(6), 6.04, and 6.05 of this revenue procedure.

(5) *Manner of making change*.

(a) A taxpayer whose average annual gross receipts, as determined under § 1.263(a)–3(h)(3), for the three preceding taxable years is less than or equal to $10,000,000 ("qualifying taxpayer") is required to complete only the following information on Form 3115:

(i) The identification section of page 1 (above Part I);

(ii) The signature section at the bottom of page 1;

(iii) Part I, line 1(a);

(iv) Part II, all lines except lines 11, 13, 14, 15, and 17;

(v) Part IV, lines 25 and 26; and

(vi) Schedule E, line 3.

(b) A taxpayer (including a qualifying taxpayer) making this change must:

(i) Apply § 1.168(i)–8(h)(1) and (3) or Prop. Reg. § 1.168(i)–8(h)(1) and (3), as applicable (accounting for asset disposed of);

(ii) If the asset (as determined under § 1.168(i)–8(c)(4) or Prop. Reg. § 1.168(i)–8(c)(4), as applicable) of which the disposed portion is a part is properly included in one of the asset classes 00.11 through 00.4 of Rev. Proc. 87–56, 1987–2 C.B. 674, classify the replacement portion of such asset under the same asset class as the disposed portion of the asset in the taxable year in which the replacement portion is placed in service by the taxpayer;

(iii) If the taxpayer's present method of accounting is not in accord with § 1.168(i)–8(c)(4) or Prop. Reg. § 1.168(i)–8(c)(4), as applicable (determination of asset disposed of), change to the appropriate asset as determined under § 1.168(i)–8(c)(4) or Prop. Reg. § 1.168(i)–8(c)(4), as applicable;

(iv) If the taxpayer continues to deduct depreciation for the disposed portion of the asset (as determined under § 1.168(i)–8(c)(4) or Prop. Reg. § 1.168(i)–8(c)(4), as applicable) under the taxpayer's present method of accounting, change from depreciating such disposed portion to recognizing gain or loss for the disposed portion or, if § 280B and § 1.280B–1 apply to the disposition, change from depreciating such disposed portion to capitalizing the loss sustained on account of the demolition to the land on which the demolished structure was located; and

(v) If any asset is public utility property within the meaning of § 168(i)(10), attach a statement to its Form 3115 providing that the taxpayer agrees to the following additional terms and conditions:

(A) A normalization method of accounting (within the meaning of § 168(i)(9)) will be used for the public utility property subject to the application;

(B) Within 30 calendar days of filing the federal income tax return for the year of change, the taxpayer will provide a copy of the completed application to any regulatory body having jurisdiction over the public utility property subject to the application; and

(C) As of the beginning of the year of change, the taxpayer will adjust its deferred tax reserve account or similar account in the taxpayer's regulatory books of account by the amount of the deferral of federal income tax liability associated with the § 481(a) adjustment applicable to the public utility property subject to the application.

(6) *Concurrent automatic change*. A taxpayer making this change for more than one asset for the same year of change should file a single Form 3115 for all such assets. If the change for more than one asset included in that Form 3115 is specified in section 6.35(1) of this APPENDIX, the single Form 3115 should provide a single net § 481(a) adjustment for all such changes. If one or more of the changes specified in section 6.35(1) of this APPENDIX in that single Form 3115 generate a negative § 481(a) adjustment and other changes specified in section 6.35(1) of this APPENDIX in that same Form 3115 generate a positive § 481(a) adjustment, the taxpayer may provide a single negative § 481(a) adjustment for all such changes that are included in that Form 3115 generating such negative adjustment and a single positive § 481(a) adjustment for all such changes that are included in that Form 3115 generating such positive adjustment.

(7) *Ogden copy of Form 3115 required in lieu of national office copy*. A taxpayer changing its method of accounting under this section 6.35 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 6.02(7)(b) (providing the mailing address) of this revenue procedure.

(8) *Designated automatic accounting method change numbers*. The designated automatic accounting method change number for a change to the method of accounting under section 6.35 of this APPENDIX is "198." *See* section 6.02(4) of this revenue procedure.

(9) *Contact information*. For further information regarding a change under this section, contact Patrick Clinton at (202) 317-7005 (not a toll-free call).

(7) Section 6.37 of the APPENDIX of Rev. Proc. 2011–14 is modified to read as follows:

6.37 *Permissible to permissible method of accounting for depreciation of MACRS property (section 168; §§ 1.168(i)–1, 1.168(i)–7, and 1.168(i)–8).*

(1) *Description of change*.

(a) *Applicability*. This change, as described in Rev. Proc. 2014–54, 2014–41 I.R.B., applies to a taxpayer that wants to make a change in method of accounting for depreciation that is specified in section 6.37(4) of this APPENDIX for an asset:

(i) to which § 168 applies (MACRS property);

(ii) for which the present and proposed methods of accounting are permissible methods of accounting under § 1.168(i)–1, § 1.168(i)–7, or § 1.168(i)–8, as applicable; and

(iii) that is owned by the taxpayer at the beginning of the year of change.

(b) *Inapplicability*. This change does not apply to any property that is not depreciated under § 168 under the taxpayer's present and proposed methods of accounting.

(2) *Certain scope limitations inapplicable*.

(a) *In general*. The scope limitation in section 4.02(5) of this revenue procedure does not apply to a taxpayer making this change.

(b) *Special rules*.

(i) The scope limitations in section 4.02(1), (2), (3), (4), (6), and (7) of this revenue procedure do not apply to a taxpayer making this change for any taxable year beginning on or after January 1, 2012, and beginning before January 1, 2015.

(ii) If a taxpayer makes both a change under this section of this APPENDIX and a change under section 6.01 of this APPENDIX for any taxable year beginning on or after January 1, 2012, and beginning before January 1, 2015, on a single Form 3115 for the same asset for the same year of change in accordance with section 6.37(6)(b) of this APPENDIX, the scope limitations in section 4.02 of this revenue procedure do not apply to the taxpayer for either change. If a taxpayer makes both a change under this section of this APPENDIX and a change under section 6.01 of this APPENDIX for any taxable year beginning on or after January 1, 2012, and beginning before January 1, 2014, on a single Form 3115 for the same asset for the same year of change in accordance with section 6.37(6)(c) of this APPENDIX, the scope limitations in section 4.02 of this revenue procedure do not apply to the taxpayer for either change.

(3) *Audit protection limited*. If a method of accounting to be changed is (a)

an issue pending for any taxable year under examination, (b) an issue under consideration by an appeals office, or (c) an issue under consideration by a federal court, the taxpayer does not receive audit protection under section 7 of this revenue procedure in connection with that change. *See* sections 6.03(6), 6.04, and 6.05 of this revenue procedure.

(4) *Changes covered*. Section 6.37 of this APPENDIX only applies to the following changes in methods of accounting for depreciation of MACRS property:

(a) For the items of MACRS property not subject to a general asset account election under § 168(i)(4) and the regulations thereunder—

(i) a change from single asset accounts (or item accounts) for specific items of MACRS property to multiple asset accounts (or pools) for the same assets, or vice versa, in accordance with § 1.168(i)–7;

(ii) a change from grouping specific items of MACRS property in multiple asset accounts to a different grouping of the same assets in multiple asset accounts in accordance with § 1.168(i)–7(c);

(iii) a change in the method of identifying which assets in multiple asset accounts or which portions of assets have been disposed of by the taxpayer from the specific identification method under § 1.168(i)–8(g)(1) to the first-in, first-out (FIFO) method of accounting under § 1.168(i)–8(g)(2)(i) or the modified FIFO method of accounting under § 1.168(i)–8(g)(2)(ii);

(iv) a change in the method of identifying which assets in multiple asset accounts or which portions of assets have been disposed of by the taxpayer from the FIFO method of accounting under § 1.168(i)–8(g)(2)(i) or the modified FIFO method of accounting under § 1.168(i)–8(g)(2)(ii) to the specific identification method under § 1.168(i)–8(g)(1);

(v) a change in the method of identifying which assets in multiple asset accounts or which portions of assets have been disposed of by the taxpayer from the FIFO method of accounting under § 1.168(i)–8(g)(2)(i) to the modified FIFO method of accounting under § 1.168(i)–8(g)(2)(ii), or vice versa;

(vi) a change in the method of identifying which mass assets (as defined in § 1.168(i)–8(b)(3)) in multiple asset accounts or which portions of mass assets have been disposed of by the taxpayer from the specific identification method under § 1.168(i)–8(g)(1) to a mortality dispersion table in accordance with § 1.168(i)–8(g)(2)(iii);

(vii) a change in the method of identifying which mass assets (as defined in § 1.168(i)–8(b)(3)) in multiple asset accounts or which portions of mass assets have been disposed of by the taxpayer from the FIFO method of accounting under § 1.168(i)–8(g)(2)(i) or the modified FIFO method of accounting under § 1.168(i)–8(g)(2)(ii) to a mortality dispersion table in accordance with § 1.168(i)–8(g)(2)(iii);

(viii) a change in the method of identifying which mass assets (as defined in § 1.168(i)–8(b)(3)) in multiple asset accounts or which portions of mass assets have been disposed of by the taxpayer from a mortality dispersion table in accordance with § 1.168(i)–8(g)(2)(iii) to the specific identification method under § 1.168(i)–8(g)(1), the FIFO method of accounting under § 1.168(i)–8(g)(2)(i), or the modified FIFO method of accounting under § 1.168(i)–8(g)(2)(ii);

(ix) if § 1.168(i)–8(f)(2) applies (disposition of an asset in a multiple asset account) and it is impracticable from the taxpayer's records to determine the unadjusted depreciable basis of the asset disposed of, a change in the method of determining the unadjusted depreciable basis of all assets in the same multiple asset account from one reasonable method to another reasonable method; or

(x) if § 1.168(i)–8(f)(3) applies (disposition of a portion of an asset) and it is impracticable from the taxpayer's records to determine the unadjusted depreciable basis of the disposed portion of the asset, a change in the method of determining the unadjusted depreciable basis of all disposed portions of the asset from one reasonable method to another reasonable method; and

(b) For the items of MACRS property subject to a general asset account election under § 168(i)(4) and the regulations thereunder—

(i) a change from grouping specific items of MACRS property in general asset accounts to a different grouping of the same assets in general asset accounts in accordance with § 1.168(i)–1(c);

(ii) a change in the method of identifying which assets or which portions of assets have been disposed of by the taxpayer from the specific identification method under § 1.168(i)–1(j)(2)(i)(A) to the FIFO method of accounting under § 1.168(i)–1(j)(2)(i)(B) or the modified FIFO method of accounting under § 1.168(i)–1(j)(2)(i)(C);

(iii) a change in the method of identifying which assets or which portions of assets have been disposed of by the taxpayer from the FIFO method of accounting under § 1.168(i)–1(j)(2)(i)(B) or the modified FIFO method of accounting under § 1.168(i)–1(j)(2)(i)(C) to the specific identification method under § 1.168(i)–1(j)(2)(i)(A);

(iv) a change in the method of identifying which assets or which portions of assets have been disposed of by the taxpayer from the FIFO method of accounting under § 1.168(i)–1(j)(2)(i)(B) to the modified FIFO method of accounting under § 1.168(i)–1(j)(2)(i)(C), or vice versa;

(v) a change in the method of identifying which mass assets (as defined in § 1.168(i)–1(b)(6)) or which portions of mass assets that are in a separate general asset account in accordance with § 1.168–1(c)(2)(ii)(H), have been disposed of by the taxpayer from the specific identification method under § 1.168(i)–1(j)(2)(i)(A) to a mortality dispersion table in accordance with § 1.168(i)–1(j)(2)(i)(D);

(vi) a change in the method of identifying which mass assets (as defined in § 1.168(i)–1(b)(6)) or which portions of mass assets that are in a separate general asset account in accordance with § 1.168–1(c)(2)(ii)(H), have been disposed of by the taxpayer from the FIFO method of accounting under § 1.168(i)–1(j)(2)(i)(B) or the modified FIFO method of accounting under § 1.168(i)–1(j)(2)(i)(C) to a mortality dispersion table in accordance with § 1.168(i)–1(j)(2)(i)(D);

(vii) a change in the method of identifying which mass assets (as defined in § 1.168(i)–1(b)(6)), or which portions of mass assets that are in a separate general asset account in accordance with § 1.168–1(c)(2)(ii)(H), have been disposed of by the taxpayer from a mortality dispersion table in accordance with § 1.168(i)–

1(j)(2)(i)(D) to the specific identification method under § 1.168(i)–1(j)(2)(i)(A), the FIFO method of accounting under § 1.168(i)–1(j)(2)(i)(B), or the modified FIFO method of accounting under § 1.168(i)–1(j)(2)(i)(C); or

(viii) if § 1.168(i)–1(j)(3) applies (basis of a disposed asset or a disposed portion of an asset in a general asset account) and it is impracticable from the taxpayer's records to determine the unadjusted depreciable basis of the disposed asset or the disposed portion of the asset, a change in the method of determining the unadjusted depreciable basis of all assets in the same general asset account from one reasonable method to another reasonable method.

(5) *Manner of making change*.

(a) The changes in methods of accounting specified in section 6.37(4)(a)(i) and (ii) and section 6.37(4)(b)(i) of this APPENDIX are made using a modified cut-off method under which the unadjusted depreciable basis and the depreciation reserve of the asset as of the beginning of the year of change are accounted for using the new method of accounting.

(i) If the change specified in section 6.37(4)(a)(i) of this APPENDIX is a change to a single asset account, the new single asset account must include a beginning balance for both the unadjusted depreciable basis and the depreciation reserve of the asset included in that single asset account.

(ii) If the change specified in section 6.37(4)(a)(i) or (ii) of this APPENDIX is a change to a multiple asset account (either a new one or a different grouping), the multiple asset account must include a beginning balance for both the unadjusted depreciable basis and the depreciation reserve. The beginning balance for the unadjusted depreciable basis of each multiple asset account is equal to the sum of the unadjusted depreciable bases as of the beginning of the year of change for all assets included in that multiple asset account. The beginning balance of the depreciation reserve of each multiple asset account is equal to the sum of the greater of the depreciation allowed or allowable as of the beginning of the year of change for all assets included in that multiple asset account.

(iii) The change specified in section 6.37(4)(b)(i) of this APPENDIX requires the general asset account to include a beginning balance for both the unadjusted depreciable basis and the depreciation reserve. The beginning balance for the unadjusted depreciable basis of each general asset account is equal to the sum of the unadjusted depreciable bases as of the beginning of the year of change for all assets included in that general asset account. The beginning balance of the depreciation reserve of each general asset account is equal to the sum of the greater of the depreciation allowed or allowable as of the beginning of the year of change for all assets included in that general asset account.

(b) The changes in methods of accounting specified in section 6.37(4)(a)(iii), (vi), (ix), and (x) and section 6.37(4)(b)(ii), (v), and (viii) of this APPENDIX are made using a cut-off method and apply to dispositions occurring on or after the beginning of the year of change.

(c) Even though the changes in methods of accounting specified in section 6.37(4)(a)(iv), (v), (vii), and (viii) and section 6.37(4)(b)(iii), (iv), (vi), and (vii) of this APPENDIX are changes from one permissible method of accounting to another permissible method of accounting, these changes are made with a § 481(a) adjustment. For the changes in methods of accounting specified in section 6.37(4)(b)(iii), (iv), (vi), and (vii) of this APPENDIX, the § 481(a) adjustment should be zero unless § 1.168(i)–1(e)(3) applies to the asset subject to the change.

(d) A taxpayer whose average annual gross receipts, as determined under § 1.263(a)–3(h)(3), for the three preceding taxable years is less than or equal to $10,000,000 ("qualifying taxpayer") is required to complete only the following information on Form 3115:

(i) The identification section of page 1 (above Part I);

(ii) The signature section at the bottom of page 1;

(iii) Part I, line 1(a);

(iv) Part II, all lines except lines 11, 13, 14, 15, and 17;

(v) Part IV, lines 24, 25, and 26; and

(vi) Schedule E, lines 3, 4a, 4b, and 4c.

(e) If any asset subject to this change is public utility property within the meaning of § 168(i)(10), a taxpayer (including a qualifying taxpayer) making this change must attach to its Form 3115 a statement providing that the taxpayer agrees to the following additional terms and conditions:

(i) A normalization method of accounting (within the meaning of § 168(i)(9)) will be used for the public utility property subject to the change;

(ii) As of the beginning of the year of change, the taxpayer will adjust its deferred tax reserve account or similar account in the taxpayer's regulatory books of account by the amount of the deferral of federal income tax liability associated with the § 481(a) adjustment applicable to a change in method of accounting specified in section 6.37(4)(a)(iv), (v), (vii), or (viii) or section 6.37(4)(b)(iii), (iv), (vi), or (vii) of this APPENDIX made for the public utility property subject to the change; and

(iii) Within 30 calendar days of filing the federal income tax return for the year of change, the taxpayer will provide a copy of the completed application to any regulatory body having jurisdiction over the public utility property subject to the change.

(6) *Concurrent automatic change*.

(a) A taxpayer making this change for more than one asset for the same year of change should file a single Form 3115 for all such assets. If the change for more than one asset included in that Form 3115 is specified in section 6.37(4)(a)(iv), (v), (vii), or (viii) or section 6.37(4)(b)(iii), (iv), (vi), or (vii) of this APPENDIX, the single Form 3115 also should provide a single net § 481(a) adjustment for all such changes. If one or more of the changes specified in section 6.37(4)(a)(iv), (v), (vii), or (viii) or section 6.37(4)(b)(iii), (iv), (vi), or (vii) of this APPENDIX in that single Form 3115 generate a negative § 481(a) adjustment and other changes specified in section 6.37(4)(a)(iv), (v), (vii), or (viii) or section 6.37(4)(b)(iii), (iv), (vi), or (vii) of this APPENDIX in that same Form 3115 generate a positive § 481(a) adjustment, the taxpayer may provide a single negative § 481(a) adjustment for all such changes that are included in that Form 3115 generating such negative adjustment and a single positive § 481(a) adjustment for all such changes that are included in that Form 3115 generating such positive adjustment.

(b) A taxpayer making this change and any change listed in this section 6.37(6)(b)(i)–(iv) of the APPENDIX for the same year of change should file a single Form 3115 for all such changes and must enter the designated automatic accounting method change numbers for the changes on the appropriate line on the Form 3115. For guidance on filing a single application for two or more changes, see section 6.02(1)(b)(ii) of this revenue procedure. The listed changes are:

(i) A change under section 6.01 of this Appendix;

(ii) A change under section 6.38 of this APPENDIX;

(iii) A change under section 6.39 of this APPENDIX; and

(iv) A change under section 6.40 of this APPENDIX.

(c) A taxpayer making a change under section 6.37(4)(b)(ii), (iii), (iv), (v), (vi), (vii), or (viii) of this APPENDIX (certain permissible to permissible changes for general asset accounts) and a change under section 6.32(1)(a)(ii), (iii), (iv), or (v) of this APPENDIX (certain late general asset account elections) and/or any change listed in this section 6.37(6)(c)(i)–(vii) of the APPENDIX for the same year of change should file a single Form 3115 for all such changes and must enter the designated automatic accounting method change numbers for the changes on the appropriate line on the Form 3115. This section 6.37(6)(c) of the APPENDIX applies only if all of these changes are made for any taxable year beginning on or after January 1, 2012, and beginning before January 1, 2014. For guidance on filing a single application for two or more changes, see section 6.02(1)(b)(ii) of this revenue procedure. The listed changes are:

(i) A change under section 6.01 of this APPENDIX;

(ii) A change under section 6.29 of this APPENDIX;

(iii) A change under section 6.30 of this APPENDIX;

(iv) A change under section 6.31 of this APPENDIX;

(v) A change under section 6.38 of this APPENDIX;

(vi) A change under section 6.39 of this APPENDIX; and

(vii) A change under section 6.40 of this APPENDIX.

(7) *Ogden copy of Form 3115 required in lieu of national office copy*. A taxpayer changing its method of accounting under this section 6.37 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 6.02(7)(b) (providing the mailing address) of this revenue procedure.

(8) *Designated automatic accounting method change numbers*. The designated automatic accounting method change number for a change to the method of accounting under section 6.37 of this APPENDIX is "200." *See* section 6.02(4) of this revenue procedure.

(9) *Contact information*. For further information regarding a change under this section, contact Patrick Clinton at (202) 317-7005 (not a toll-free call).

(8) Section 10.11(1)(b)(ii) of the APPENDIX of Rev. Proc. 2011–14 is modified to read as follows:

(ii) Amounts paid or incurred for certain materials and supplies that the taxpayer has elected to capitalize and depreciate under § 1.162–3(d) or § 1.162–3T(d);

.03 *New automatic changes*.

(1) Rev. Proc. 2011–14 is modified to add new section 6.38 to the APPENDIX to read as follows:

6.38 *Disposition of a building or structural component (section 168; § 1.168(i)–8)*.

(1) *Description of change*.

(a) *Applicability*. This change, as described in Rev. Proc. 2014–54, 2014–41 I.R.B., applies to a taxpayer that wants to make a change in method of accounting that is specified in section 6.38(4) of this APPENDIX for disposing of a building or a structural component or disposing of a portion of a building (including its structural components) to which the partial disposition rule in § 1.168(i)–8(d)(1) applies. These specified changes are consistent with §§ 1.168(i)–8(b)(2), 1.168(i)–8(c)(4)(ii)(A), (B), and (D), 1.168(i)–8(f), and 1.168(i)–8(g), as applicable. This change also affects the determination of gain or loss from disposing of the building, the structural component, or the portion of the building (including its structural components) and may affect whether the taxpayer must capitalize amounts paid to restore a unit of property (as determined under § 1.263(a)–3(e) or (f)) under § 1.263(a)–3(k).

(b) *Inapplicability*. This change does not apply to the following:

(i) Any asset (as determined under § 1.168(i)–8(c)(4)) that is not depreciated under § 168 under the taxpayer's present method of accounting and, if applicable, under the taxpayer's proposed method of accounting;

(ii) Any asset subject to a general asset account election under § 168(i)(4) and the regulations thereunder (but see section 6.40 of this APPENDIX for making a change in method of accounting for dispositions of tangible depreciable assets subject to a general asset account election);

(iii) Any multiple buildings, condominium units, or cooperative units that are treated as a single building under the taxpayer's present method of accounting, or will be treated as a single building under the taxpayer's proposed method of accounting, pursuant to § 1.1250–1(a)(2)(ii);

(iv) Any disposition of a portion of an asset for which a partial disposition election under § 1.168(i)–8(d)(2) is required but for which the taxpayer did not make such election in accordance with § 1.168(i)–8(d)(2)(ii) or (iii), as applicable (but see section 6.33 of this APPENDIX for making a late partial disposition election and section 6.35 of this APPENDIX for making a partial disposition election pursuant to § 1.168(i)–8(d)(2)(iii)); or

(v) Any demolition of a structure to which § 280B and § 1.280B–1 apply.

(2) *Certain scope limitations inapplicable*.

(a) *In general*. The scope limitation in section 4.02(5) of this revenue procedure does not apply to a taxpayer making this change.

(b) *Special rules*.

(i) The scope limitations in section 4.02(1), (2), (3), (4), (6), and (7) of this revenue procedure do not apply to a taxpayer making this change for any taxable year beginning on or after January 1, 2012, and beginning before January 1, 2015.

(ii) If a taxpayer makes both a change under this section of this APPENDIX and a change under section 6.01 of this APPENDIX for any taxable year beginning on or after January 1, 2012, and beginning before January 1, 2015, on a single Form 3115 for the same asset for the same year of change in accordance with section 6.38(10)(b) or (c) of this APPENDIX, the scope limitations in section 4.02 of this revenue procedure do not apply to the taxpayer for either change.

(3) *Audit protection limited*. If a method of accounting to be changed is (a) an issue pending for any taxable year under examination, (b) an issue under consideration by an appeals office, or (c) an issue under consideration by a federal court, the taxpayer does not receive audit protection under section 7 of this revenue procedure in connection with that change. *See* sections 6.03(6), 6.04, and 6.05 of this revenue procedure.

(4) *Covered changes*. Section 6.38 of this APPENDIX only applies to the following changes in methods of accounting for a building (including its structural components), condominium unit (including its structural components), cooperative unit (including its structural components), or an improvement or addition (including its structural components) thereto:

(a) For purposes of applying § 1.168(i)–8(c)(4) (determination of asset disposed of), a change to the appropriate asset as determined under § 1.168(i)–8(c)(4)(ii)(A), (B), or (D), as applicable;

(b) If the taxpayer makes the change specified in section 6.38(4)(a) of this APPENDIX, and if the taxpayer disposed of the asset as determined under section 6.38(4)(a) of this APPENDIX or disposed of a portion of such asset in a taxable year prior to the year of change but under its present method of accounting continues to deduct depreciation for such disposed asset or such disposed portion, a change from depreciating the disposed asset or disposed portion to recognizing gain or loss upon disposition;

(c) If the taxpayer's present method of accounting for its buildings (including their structural components), condominium units (including their structural components), cooperative units (including their structural components), and improvements or additions (including its structural components) thereto that are depreciated under § 168 is in accord with § 1.168(i)–8(c)(4)(ii)(A), (B), and (D), and if the taxpayer disposed of an asset as determined under § 1.168(i)–8(c)(4)(ii)(A), (B), or (D), as applicable, or disposed of a portion of such asset in a taxable year prior to the year of change but under its present method of accounting continues to deduct depreciation for such disposed asset or such disposed portion, a change from depreciating the disposed asset or disposed portion to recognizing gain or loss upon disposition;

(d) A change in the method of identifying which assets in multiple asset accounts or which portions of assets have been disposed of from a method of accounting not specified in § 1.168(i)–8(g)(1) or (2)(i), (ii), or (iii) (for example, the last-in, first-out (LIFO) method of accounting) to a method of accounting specified in § 1.168(i)–8(g)(1) or (2)(i), (ii), or (iii), as applicable;

(e) If § 1.168(i)–8(f)(2) applies (disposition of an asset in a multiple asset account) and it is practicable from the taxpayer's records to determine the unadjusted depreciable basis of the disposed asset, a change in the method of determining the unadjusted depreciable basis of the disposed asset from a method of not using the taxpayer's records to a method of using the taxpayer's records;

(f) If § 1.168(i)–8(f)(2) applies (disposition of an asset in a multiple asset account) and it is impracticable from the taxpayer's records to determine the unadjusted depreciable basis of the disposed asset, a change in the method of determining the unadjusted depreciable basis of all assets in the same multiple asset account from an unreasonable method (for example, discounting the cost of the replacement asset to its placed-in-service year cost using the Consumer Price Index) to a reasonable method;

(g) If § 1.168(i)–8(f)(3) applies (disposition of a portion of an asset) and it is practicable from the taxpayer's records to determine the unadjusted depreciable basis of the disposed portion of the asset, a change in the method of determining the unadjusted depreciable basis of the disposed portion of the asset from a method of not using the taxpayer's records to a method of using the taxpayer's records;

(h) If § 1.168(i)–8(f)(3) applies (disposition of a portion of an asset) and it is impracticable from the taxpayer's records to determine the unadjusted depreciable basis of the disposed portion of the asset, a change in the method of determining the unadjusted depreciable basis of the disposed portion of the asset from an unreasonable method (for example, discounting the cost of the replacement portion of the asset to its placed-in-service year cost using the Consumer Price Index) to a reasonable method; or

(i) A change from recognizing gain or loss under § 1.168(i)–8T upon the disposition of an asset (as determined under § 1.168(i)–8(c)(4)(ii)(A), (B), or (D), as applicable) included in a general asset account to recognizing gain or loss upon the disposition of the same asset under § 1.168(i)–8 if: (A) the taxpayer makes the change specified in section 6.34 of this APPENDIX (revocation of a general asset account election); (B) the taxpayer made a qualifying disposition election under § 1.168(i)–1T(e)(3)(iii) in a taxable year prior to the year of change for the disposition of such asset; (C) the taxpayer's present method of accounting for such asset is in accord with § 1.168(i)–8(c)(4)(ii)(A), (B), or (D), as applicable; and (D) the taxpayer recognized a gain or loss under § 1.168(i)–8T upon the disposition of such asset in a taxable year prior to the year of change.

(5) *Examples*. The following examples illustrate the covered changes specified in section 6.38(4) of this APPENDIX.

(a) *Example 1*. X, a calendar-year taxpayer, acquired and placed in service a building and its structural components in 2000. In 2005, X constructed and placed in service an addition to this building. X depreciates the building, the addition, and their structural components under § 168. A change by X to treating the original building (including its structural components) as an asset and the addition to the building (including the structural components of such addition) as a separate asset for disposition purposes is a change described in section 6.38(4)(a) of this APPENDIX solely for purposes of § 1.168(i)–8(c)(4).

(b) *Example 2*. Y, a calendar year taxpayer, acquired and placed in service a building and its structural components in 1990. Y depreciates this building and its structural components under § 168. In 2000, a tornado damaged the roof and, as a result, Y replaced the entire roof of the building. Y did not recognize a loss on the retirement of the original roof and continues to depreciate the original roof. Y also capitalized the cost of the replacement roof and has been depreciating this roof under § 168 since 2000. Because the original roof was disposed of as a result of a casualty event described in § 165, a change by Y from depreciating the original roof to recognizing a loss upon its retirement is a covered change described in section 6.38(4)(c) of this APPENDIX solely for purposes of § 1.168(i)–8.

(c) *Example 3*. The facts are the same as in *Example 2*, except a tornado did not occur, but Y still replaced the entire roof of the building in 2000. Because the original roof was not disposed of as a result of any of the events described in § 1.168(i)–8(d)(1) that require a partial disposition, a partial disposition election must be made to change from depreciating the original roof to recognizing a loss upon its retirement. Pursuant to section 6.38(1)(b)(iv) of this APPENDIX, section 6.38 does not apply to the disposition of the original roof in 2000. But see section 6.33 of this APPENDIX for making the late partial disposition election under § 1.168(i)–8(d)(2)(i) for the original roof.

(6) *Manner of making change*.

(a) A taxpayer (including a qualifying taxpayer as defined in section 6.38(6)(b) of this APPENDIX) making this change must attach to its Form 3115 a statement with the following:

(i) A description of the assets to which this change applies;

(ii) If the taxpayer is making a change specified in section 6.38(4)(a) of this APPENDIX, a description of the assets for disposition purposes under the taxpayer's present and proposed methods of accounting;

(iii) If the taxpayer is making the change specified in section 6.38(4)(d) of this APPENDIX, a description of the methods of identifying which assets have been disposed of under the taxpayer's present and proposed methods of accounting;

(iv) If the taxpayer is making the change specified in section 6.38(4)(f) or (h) of this APPENDIX, a description of the methods of determining the unadjusted depreciable basis of the disposed asset or disposed portion of the asset, as applicable, under the taxpayer's present and proposed methods of accounting; and

(v) If any asset is public utility property within the meaning of § 168(i)(10), a statement providing that the taxpayer agrees to the following additional terms and conditions:

(A) A normalization method of accounting (within the meaning of § 168(i)(9)) will be used for the public utility property subject to the application;

(B) As of the beginning of the year of change, the taxpayer will adjust its deferred tax reserve account or similar account in the taxpayer's regulatory books of account by the amount of the deferral of federal income tax liability associated with the § 481(a) adjustment applicable to the public utility property subject to the application; and

(C) Within 30 calendar days of filing the federal income tax return for the year of change, the taxpayer will provide a copy of the completed application to any regulatory body having jurisdiction over the public utility property subject to the application.

(b) A taxpayer whose average annual gross receipts, as determined under § 1.263(a)–3(h)(3), for the three preceding taxable years is less than or equal to $10,000,000 ("qualifying taxpayer") is required to complete only the following information on Form 3115:

(i) The identification section of page 1 (above Part I);

(ii) The signature section at the bottom of page 1;

(iii) Part I, line 1(a);

(iv) Part II, all lines except lines 11, 13, 14, 15, and 17;

(v) Part IV, lines 25 and 26; and

(vi) Schedule E, line 3.

(7) *No ruling on asset*. The consent granted under this revenue procedure for a change specified in section 6.38(4)(a) of this APPENDIX is not a determination by the Commissioner that the taxpayer is using the appropriate asset under § 1.168(i)–8(c)(4) for determining what asset is disposed of by the taxpayer and does not create any presumption that the proposed asset is permissible under § 1.168(i)–8(c)(4). The director will ascertain whether the taxpayer's determination of its asset under § 1.168(i)–8(c)(4) is permissible.

(8) *Section 481(a) adjustment*. A taxpayer changing its method of accounting under section 6.38 of the APPENDIX may use statistical sampling in determining the § 481(a) adjustment by following the guidance provided in Rev. Proc. 2011–42, 2011–37 I.R.B. 318.

(9) *Section 481(a) adjustment period*.

(a) A taxpayer must take the entire amount of the § 481(a) adjustment into account in computing taxable income for the year of change:

(i) If the taxpayer is making the change specified in section 6.38(4)(a) of this APPENDIX and if the taxpayer recognized a gain or loss under § 1.168(i)–8T on the disposition of the asset (or if applicable, a portion thereof) in a taxable year prior to the year of change; or

(ii) If the taxpayer is making the change specified in section 6.38(4)(i) of this APPENDIX.

(b) If section 6.38(9)(a) of this APPENDIX does not apply, see section 5.04 of this revenue procedure for the § 481(a) adjustment period.

(c) *Example*. (i) Y, a calendar year taxpayer, acquired and placed in service a building and its structural components in 2000. Y depreciates this building and its structural components under § 168. The roof is a structural component of the building. Y replaced the entire roof in 2010. On its federal tax return for the taxable year ended December 31, 2010, Y did not recognize a loss on the retirement of the original roof and continues to depreciate the original roof. Y also capitalized the cost of the replacement roof and has been depreciating this roof under § 168 since June 2010. The adjusted depreciable basis of the original roof at the time of its retirement in 2010 (taking into account the applicable convention) is $11,000, and Y claimed depreciation of $1,000 for such roof after its retirement (taking into account the applicable convention) and before the 2012 taxable year. Also the 12-month allowable depreciation deduction for the original roof is $500 for the 2012 taxable year and $500 for the 2013 taxable year.

(ii) In accordance with § 1.168(i)–8T(c)(4)(ii)(A) and (B) and section 6.29(3)(a) and (b) of the APPENDIX to Rev. Proc. 2011–14, as modified by Rev. Proc. 2012–20, 2012–14 I.R.B. 700, Y filed with its federal income tax return for the taxable year ended December 31, 2012, a Form 3115 to treat the building as an asset and each structural component of the building as a separate asset for disposition purposes and also to change from depreciating the original roof to recognizing a loss upon its retirement. The amount of the net negative § 481(a) adjustment on this Form 3115 is $10,000 (adjusted depreciable basis of $11,000 for the original roof at the time of its retirement (taking into account the applicable convention) less depreciation of $1,000 claimed for such roof after its retirement (taking into account the applicable convention) and before the 2012 taxable year).

(iii) Y complies with § 1.168(i)–8 beginning with its taxable year ending December 31, 2014, but decides not to make any late partial disposition election under section 6.33 of this APPENDIX. In accordance with section 6.38(4)(a) of this APPENDIX, Y files a Form 3115 with its 2014 federal income tax return to change to treating the original building (including its original roof and other original structural components) as an asset and the replacement roof as a separate asset for disposition purposes. Because Y is not making a late partial disposition election for the original roof, Y does not recognize the net loss of $10,000 upon the retirement of the original roof under § 1.168(i)–8 and Y will continue to depreciate the original roof. Thus, the net positive § 481(a) adjustment for this change is $9,000 (net loss of $10,000 claimed on the 2012 return for the retirement of the original roof less depreciation of $1,000 for the original roof for 2012 and 2013) and is included in Y's taxable income for 2014.

(10) *Concurrent automatic change*.

(a) A taxpayer making this change for more than one asset for the same year of change should file a single Form 3115 for all such assets and provide a single net § 481(a) adjustment for all the changes included in that Form 3115. If one or more of the changes in that single Form 3115 generate a negative § 481(a) adjustment and other changes in that same Form 3115 generate a positive § 481(a) adjustment, the taxpayer may provide a single negative § 481(a) adjustment for all the changes that are included in that Form 3115 generating such negative adjustment and a single positive § 481(a) adjustment for all the changes that are included in that Form 3115 generating such positive adjustment.

(b) A taxpayer making this change and any change listed in this section 6.38(10)(b)(i)–(iv) of the APPENDIX for the same year of change should file a single Form 3115 for all of such changes and must enter the designated automatic accounting method change numbers for the changes on the appropriate line on the Form 3115. For guidance on filing a single application for two or more changes, see section 6.02(1)(b)(ii) of this revenue procedure. The listed changes are:

(i) A change under section 6.01 of this APPENDIX;

(ii) A change under section 6.37 of this APPENDIX;

(iii) A change under section 6.39 of this APPENDIX; and

(iv) A change under section 6.40 of this APPENDIX.

(c) A taxpayer making this change and a change under section 6.34 of this APPENDIX (revocation of a general asset account election) and/or any change listed in this section 6.38(10)(c)(i)–(iii) of the APPENDIX for the same year of change should file a single Form 3115 for all such changes and must enter the designated automatic accounting method change numbers for the changes on the appropriate line on the Form 3115. This section 6.38(10)(c) of the APPENDIX applies only if all of these changes are made for any taxable year beginning on or after January 1, 2012, and beginning before January 1, 2015. For guidance on filing a single application for two or more changes, see section 6.02(1)(b)(ii) of this revenue procedure. The listed changes are:

(i) A change under section 6.01 of this APPENDIX;

(ii) A change under section 6.37(4)(a) of this APPENDIX; and

(iii) A change under section 6.39 of this APPENDIX.

(11) *Ogden copy of Form 3115 required in lieu of national office copy*. A taxpayer changing its method of accounting under this section 6.38 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 6.02(7)(b) (providing the mailing address) of this revenue procedure.

(12) *Designated automatic accounting method change numbers*. The designated automatic accounting method change number for a change to the method of accounting under section 6.38 of this APPENDIX is "205." *See* section 6.02(4) of this revenue procedure.

(13) *Contact information*. For further information regarding a change under this section, contact Patrick Clinton at (202) 317-7005 (not a toll-free call).

(2) Rev. Proc. 2011–14 is modified to add new section 6.39 to the APPENDIX to read as follows:

6.39 *Dispositions of tangible depreciable assets (other than a building or its structural components) (section 168; § 1.168(i)–8)*.

(1) *Description of change*.

(a) *Applicability*. This change, as described in Rev. Proc. 2014–54, 2014–41 I.R.B., applies to a taxpayer that wants to make a change in method of accounting that is specified in section 6.39(4) of this APPENDIX for disposing of section 1245 property or a depreciable land improvement or disposing of a portion of section 1245 property or a depreciable land improvement to which the partial disposition rule in § 1.168(i)–8(d)(1) applies. These specified changes are consistent with §§ 1.168(i)–8(c)(4)(i), 1.168(i)–8(c)(4)(ii)(C) and (D), 1.168(i)–8(f), and 1.168(i)–8(g), as applicable. This change also affects the determination of gain or loss from disposing of the section 1245 property, the depreciable land improvement, or a portion of the section 1245 property or depreciable land improvement, and may affect whether the taxpayer must capitalize amounts paid to restore a unit of property (as determined under § 1.263(a)–3T(e) or (f) , or § 1.263(a)–3(e) or (f), as applicable) under § 1.263(a)–3T(i) or § 1.263(a)–3(k), as applicable.

(b) *Inapplicability*. This change does not apply to the following:

(i) Any asset (as determined under § 1.168(i)–8(c)(4)) that is not depreciated under § 168 under the taxpayer's present method of accounting and, if applicable, under the taxpayer's proposed method of accounting;

(ii) Any building (including its structural components), condominium unit (including its structural components), cooperative unit (including its structural components), or an improvement or addition (including its structural components) thereto (but see section 6.38 of this APPENDIX for making this change);

(iii) Any asset subject to a general asset account election under § 168(i)(4) and the regulations thereunder (but see section 6.40 of this APPENDIX for making a change for dispositions of tangible depreciable assets subject to a general asset account election); or

(iv) Any disposition of a portion of an asset for which a partial disposition election under § 1.168(i)–8(d)(2) is required but for which the taxpayer did not make such election in accordance with § 1.168(i)–8(d)(2)(ii) or (iii), as applicable (but see section 6.33 of this APPENDIX for making a late partial disposition election and section 6.35 of this APPENDIX for making a partial disposition election pursuant to § 1.168(i)–8(d)(2)(iii)).

(2) *Certain scope limitations inapplicable*.

(a) *In general*. The scope limitation in section 4.02(5) of this revenue procedure does not apply to a taxpayer making this change.

(b) *Special rules*.

(i) The scope limitations in section 4.02(1), (2), (3), (4), (6), and (7) of this revenue procedure do not apply to a taxpayer making this change for any taxable year beginning on or after January 1, 2012, and beginning before January 1, 2015.

(ii) If a taxpayer makes both a change under this section of this APPENDIX and a change under section 6.01 of this APPENDIX for any taxable year beginning on or after January 1, 2012, and beginning before January 1, 2015, on a single Form 3115 for the same asset for the same year of change in accordance with section 6.39(9)(b) or (c) of this APPENDIX, the scope limitations in section 4.02 of this revenue procedure do not apply to the taxpayer for either change.

(3) *Audit protection limited*. If a method of accounting to be changed is (a) an issue pending for any taxable year under examination, (b) an issue under consideration by an appeals office, or (c) an issue under consideration by a federal court, the taxpayer does not receive audit protection under section 7 of this revenue procedure in connection with this change. *See* sections 6.03(6), 6.04, and 6.05 of this revenue procedure.

(4) *Covered changes*. Section 6.39 of this APPENDIX only applies to the following changes in methods of accounting for a section 1245 property, a depreciable land improvement, or an improvement or addition thereto:

(a) For purposes of applying § 1.168(i)–8(c)(4) (determination of asset disposed of), a change to the appropriate asset as determined under § 1.168(i)–8(c)(4)(i), (ii)(C), or (ii)(D), as applicable;

(b) If the taxpayer makes the change specified in section 6.39(4)(a) of this APPENDIX, and if the taxpayer disposed of the asset as determined under section 6.39(4)(a) of this APPENDIX or disposed of a portion of such asset in a taxable year prior to the year of change but continues to deduct depreciation for such disposed asset or such disposed portion, as applicable, under the taxpayer's present method of accounting, a change from depreciating the disposed asset or disposed portion, as applicable, to recognizing gain or loss upon disposition;

(c) If the taxpayer's present method of accounting for the section 1245 property, the depreciable land improvement, or the improvement or addition thereto is in accord with § 1.168(i)–8(c)(4)(i) or (ii), as applicable, and if the taxpayer disposed of such asset or a portion of such asset in a taxable year prior to the year of change but under its present method of accounting continues to deduct depreciation for this disposed asset or disposed portion, as applicable, a change from depreciating the disposed asset or disposed portion, as applicable, to recognizing gain or loss upon disposition;

(d) A change in the method of identifying which assets in multiple asset accounts or which portions of assets have been disposed of from a method of accounting not specified in § 1.168(i)–8(g)(1) or (2)(i), (ii), or (iii) (for example, the last-in, first-out (LIFO) method of accounting) to a method of accounting specified in § 1.168(i)–8(g)(1) or (2)(i), (ii), or (iii), as applicable;

(e) If § 1.168(i)–8(f)(2) applies (disposition of an asset in a multiple asset account) and it is practicable from the taxpayer's records to determine the unadjusted depreciable basis of the disposed asset, a change in the method of determining the unadjusted depreciable basis of the disposed asset from a method of not using the taxpayer's records to a method of using the taxpayer's records;

(f) If § 1.168(i)–8(f)(2) applies (disposition of an asset in a multiple asset account) and it is impracticable from the taxpayer's records to determine the unadjusted depreciable basis of the disposed asset, a change in the method of determining the unadjusted depreciable basis of all assets in the same multiple asset account from an unreasonable method (for example, discounting the cost of the replacement asset to its placed-in-service year cost using the Consumer Price Index) to a reasonable method;

(g) If § 1.168(i)–8(f)(3) applies (disposition of a portion of an asset) and it is practicable from the taxpayer's records to determine the unadjusted depreciable basis of the disposed portion of the asset, a change in the method of determining the unadjusted depreciable basis of the disposed portion of the asset from a method of not using the taxpayer's records to a method of using the taxpayer's records;

(h) If § 1.168(i)–8(f)(3) applies (disposition of a portion of an asset) and it is impracticable from the taxpayer's records to determine the unadjusted depreciable basis of the disposed portion of the asset, a change in the method of determining the unadjusted depreciable basis of the disposed portion of the asset from an unreasonable method (for example, discounting the cost of the replacement portion of the asset to its placed-in-service year cost using the Consumer Price Index) to a reasonable method; or

(i) A change from recognizing gain or loss under § 1.168(i)–8T upon the disposition of a section 1245 property, depreciable land improvement, or improvement or addition thereto included in a general asset account to recognizing gain or loss upon the disposition of the same asset under § 1.168(i)–8 if: (A) the taxpayer makes the change specified in section 6.34 of this APPENDIX (revocation of a general asset account election); (B) the taxpayer made a qualifying disposition election under § 1.168(i)–1T(e)(3)(iii) in a taxable year prior to the year of change for the disposition of such asset; (C) the taxpayer's present method of accounting for such asset is in accord with § 1.168(i)–8(c)(4)(i) or (ii), as applicable; and (D) the taxpayer recognized a gain or loss under § 1.168(i)–8T on the disposition of such asset in a taxable year prior to the year of change.

(5) *Manner of making change*.

(a) A taxpayer (including a qualifying taxpayer as defined in section 6.39(5)(b) of this APPENDIX) making this change must attach to its Form 3115 a statement with the following:

(i) A description of the assets to which this change applies;

(ii) If the taxpayer is making a change specified in section 6.39(4)(a) of this APPENDIX, a description of the assets for disposition purposes under the taxpayer's present and proposed methods of accounting;

(iii) If the taxpayer is making the change specified in section 6.39(4)(d) of this APPENDIX, a description of the methods of identifying which assets have been disposed of under the taxpayer's present and proposed methods of accounting;

(iv) If the taxpayer is making the change specified in section 6.38(4)(f) or (h) of this APPENDIX, a description of the methods of determining the unadjusted depreciable basis of the disposed asset or disposed portion of the asset, as applicable, under the taxpayer's present and proposed methods of accounting; and

(v) If any asset is public utility property within the meaning of § 168(i)(10), a statement providing that the taxpayer agrees to the following additional terms and conditions:

(A) A normalization method of accounting (within the meaning of § 168(i)(9)) will be used for the public utility property subject to the application;

(B) As of the beginning of the year of change, the taxpayer will adjust its deferred tax reserve account or similar account in the taxpayer's regulatory books of account by the amount of the deferral of federal income tax liability associated with the § 481(a) adjustment applicable to the public utility property subject to the application; and

(C) Within 30 calendar days of filing the federal income tax return for the year of change, the taxpayer will provide a copy of the completed application to any regulatory body having jurisdiction over the public utility property subject to the application.

(b) A taxpayer whose average annual gross receipts, as determined under § 1.263(a)–3(h)(3), for the three preceding taxable years is less than or equal to $10,000,000 ("qualifying taxpayer") is required to complete only the following information on Form 3115:

(i) The identification section of page 1 (above Part I);

(ii) The signature section at the bottom of page 1;

(iii) Part I, line 1(a);

(iv) Part II, all lines except lines 11, 13, 14, 15, and 17;

(v) Part IV, lines 25 and 26; and

(vi) Schedule E, line 3.

(6) *No ruling on asset*. The consent granted under this revenue procedure for a change specified in section 6.39(4)(a) of this APPENDIX is not a determination by the Commissioner that the taxpayer is using the appropriate asset under § 1.168(i)–8(c)(4) for determining what asset is disposed of by the taxpayer and does not create any presumption that the proposed asset is permissible under § 1.168(i)–8(c)(4). The director will ascertain whether the taxpayer's determination of its asset under § 1.168(i)–8(c)(4) is permissible.

(7) *Section 481(a) adjustment*. A taxpayer changing its method of accounting under section 6.39 of the APPENDIX may use statistical sampling in determining the § 481(a) adjustment by following the guidance provided in Rev. Proc. 2011–42, 2011–37 I.R.B. 318.

(8) *Section 481(a) adjustment period*.

(a) A taxpayer must take the entire amount of the § 481(a) adjustment into account in computing taxable income for the year of change:

(i) If the taxpayer is making the change specified in section 6.39(4)(a) of this APPENDIX and if the taxpayer recognized a gain or loss under § 1.168(i)–8T on the disposition of the section 1245 property, depreciable land improvement, or improvement or addition thereto (or if applicable, a portion of such asset) in a taxable year prior to the year of change; or

(ii) If the taxpayer is making the change specified in section 6.39(4)(i) of this APPENDIX.

(b) If section 6.39(8)(a) of this APPENDIX does not apply, see section 5.04 of this revenue procedure for the § 481(a) adjustment period.

(9) *Concurrent automatic change*.

(a) A taxpayer making this change for more than one asset for the same year of change should file a single Form 3115 for all such assets and provide a single net § 481(a) adjustment for all the changes included in that Form 3115. If one or more of the changes in that single Form 3115 generate a negative § 481(a) adjustment and other changes in that same Form 3115 generate a positive § 481(a) adjustment, the taxpayer may provide a single negative § 481(a) adjustment for all the changes that are included in that Form 3115 generating such negative adjustment and a single positive § 481(a) adjustment for all the changes that are included in that Form 3115 generating such positive adjustment. For guidance on filing a single application for two or more changes, see section 6.02(1)(b)(ii) of Rev. Proc. 2011–14.

(b) A taxpayer making this change and any change listed in this section 6.39(9)(b)(i)–(iv) of the APPENDIX for the same year of change should file a single Form 3115 for all of such changes and must enter the designated automatic accounting method change numbers for the changes on the appropriate line on the Form 3115. For guidance on filing a single application for two or more changes, see section 6.02(1)(b)(ii) of this revenue procedure. The listed changes are:

(i) A change under section 6.01 of this APPENDIX;

(ii) A change under section 6.37 of this APPENDIX;

(iii) A change under section 6.38 of this APPENDIX; and

(iv) A change under section 6.40 of this APPENDIX.

(c) A taxpayer making this change and a change under section 6.34 of this APPENDIX (revocation of a general asset account election) and/or any change listed in this section 6.39(9)(c)(i)–(iii) of the APPENDIX for the same year of change should file a single Form 3115 for all such changes and must enter the designated automatic accounting method change numbers for the changes on the appropriate line on the Form 3115. This section 6.39(9)(c) of the APPENDIX applies only if all of these changes are made for any taxable year beginning on or after January 1, 2012, and beginning before January 1, 2015. For guidance on filing a single application for two or more changes, see section 6.02(1)(b)(ii) of this revenue procedure. The listed changes are:

(i) A change under section 6.01 of this APPENDIX;

(ii) A change under section 6.37(4)(a) of this APPENDIX; and

(iii) A change under section 6.38 of this APPENDIX.

(10) *Ogden copy of Form 3115 required in lieu of national office copy*. A taxpayer changing its method of accounting under this section 6.39 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 6.02(7)(b) (providing the mailing address) of this revenue procedure.

(11) *Designated automatic accounting method change numbers*. The designated automatic accounting method change number for a change to the method of accounting under section 6.39 of this APPENDIX is "206." *See* section 6.02(4) of this revenue procedure.

(12) *Contact information*. For further information regarding a change under this section, contact Patrick Clinton at (202) 317-7005 (not a toll-free call).

(3) Rev. Proc. 2011–14 is modified to add new section 6.40 to the APPENDIX to read as follows:

6.40 *Dispositions of tangible depreciable assets in a general asset account (section 168(i)(4); § 1.168(i)–1).*

(1) *Description of change*.

(a) *Applicability*. This change, as described in Rev. Proc. 2014–54, 2014–41 I.R.B., applies to a taxpayer that wants to make a change in method of accounting that is specified in section 6.40(4) of this APPENDIX for disposing of an asset subject to a general asset account election under § 168(i)(4) and the regulations thereunder. These specified changes are consistent with §§ 1.168(i)–1(e)(1), 1.168(i)–1(e)(2)(viii), and 1.168(i)–1(j), as applicable. This change also may affect the determination of gain or loss from disposing of the asset and may affect whether the taxpayer must capitalize amounts paid to restore a unit of property (as determined under § 1.263(a)–3T(e) or (f), or § 1.263(a)–3(e) or (f), as applicable) under § 1.263(a)–3T(i) or § 1.263(a)–3(k), as applicable.

(b) *Inapplicability*. This change does not apply to the following:

(i) Any asset (as determined under § 1.168(i)–1(e)(2)(viii)) that is not depreciated under § 168 under the taxpayer's present method of accounting and, if applicable, proposed method of accounting; or

(ii) Any asset not subject to a general asset account election under § 168(i)(4) and the regulations thereunder (but see sections 6.38 and 6.39 of this APPENDIX for making a change for dispositions of tangible depreciable assets not subject to a general asset account election).

(2) *Certain scope limitations inapplicable*.

(a) *In general*. The scope limitation in section 4.02(5) of this revenue procedure does not apply to a taxpayer making this change.

(b) *Special rules*.

(i) The scope limitations in section 4.02(1), (2), (3), (4), (6), and (7) of this revenue procedure do not apply to a taxpayer making this change for any taxable year beginning on or after January 1, 2012, and beginning before January 1, 2015.

(ii) If a taxpayer makes both a change under this section of this APPENDIX and a change under section 6.01 of this APPENDIX for any taxable year beginning on or after January 1, 2012, and beginning before January 1, 2015, on a single Form 3115 for the same asset for the same year of change in accordance with section 6.40(8)(b) of this APPENDIX, the scope limitations in section 4.02 of this revenue procedure do not apply to the taxpayer for either change. If a taxpayer makes both a change under this section of this APPENDIX and a change under section 6.01 of this APPENDIX for any taxable year beginning on or after January 1, 2012, and beginning before January 1, 2014, on a single Form 3115 for the same asset for the same year of change in accordance with section 6.40(8)(c) of this APPENDIX, the scope limitations in section 4.02 of this revenue procedure do not apply to the taxpayer for either change.

(3) *Audit protection limited*. If a method of accounting to be changed is (a) an issue pending for any taxable year under examination, (b) an issue under consideration by an appeals office, or (c) an issue under consideration by a federal court, the taxpayer does not receive audit protection under section 7 of this revenue procedure in connection with that change. *See* sections 6.03(6), 6.04, and 6.05 of this revenue procedure.

(4) *Covered changes*. Section 6.40 of this APPENDIX only applies to the following changes in methods of accounting for an asset subject to a general asset account election under § 168(i)(4) and the regulations thereunder:

(a) For purposes of applying § 1.168(i)–1(e)(2)(viii) (determination of asset disposed of), a change to the appropriate asset as determined under § 1.168(i)–1(e)(2)(viii)(A) or (B), as applicable;

(b) A change in the method of identifying which assets or which portions of assets have been disposed of from a method of accounting not specified in § 1.168(i)–1(j)(2)(i)(A), (B), (C), or (D) (for example, the last-in, first-out (LIFO) method of accounting) to a method of accounting specified in § 1.168(i)–1(j)(2)(i)(A), (B), (C), or (D), as applicable;

(c) If § 1.168(i)–1(j)(3) applies (basis of disposed asset or disposed portion of an asset) and it is practicable from the taxpayer's records to determine the unadjusted depreciable basis of the disposed asset or the disposed portion of an asset, as applicable, a change in the method of determining the unadjusted depreciable basis of the disposed asset or the disposed portion of an asset, as applicable, from a method of not using the taxpayer's records to a method of using the taxpayer's records; or

(d) If § 1.168(i)–1(j)(3) applies (basis of disposed asset or disposed portion of an asset) and it is impracticable from the taxpayer's records to determine the unadjusted depreciable basis of the disposed asset or the disposed portion of an asset, as applicable, a change in the method of determining the unadjusted depreciable basis of all assets in the same general asset account from an unreasonable method (for example, discounting the cost of the replacement asset to its placed-in-service year cost using the Consumer Price Index) to a reasonable method.

(5) *Manner of making change*.

(a) A taxpayer (including a qualifying taxpayer as defined in section 6.40(5)(b) of this APPENDIX) making this change must attach to its Form 3115 a statement with the following:

(i) A description of the assets to which this change applies;

(ii) If the taxpayer is making the change specified in section 6.40(4)(a) of this APPENDIX, a description of the assets for disposition purposes under the taxpayer's present and proposed methods of accounting;

(iii) If the taxpayer is making the change specified in section 6.40(4)(b) of this APPENDIX, a description of the methods of identifying which assets have been disposed of under the taxpayer's present and proposed methods of accounting;

(iv) If the taxpayer is making the change specified in section 6.40(4)(d) of this APPENDIX, a description of the methods of determining the unadjusted depreciable basis of the disposed asset or disposed portion of the asset, as applicable, under the taxpayer's present and proposed methods of accounting; and

(v) If any asset is public utility property within the meaning of § 168(i)(10), a statement providing that the taxpayer agrees to the following additional terms and conditions:

(A) A normalization method of accounting (within the meaning of § 168(i)(9)) will be used for the public utility property subject to the application;

(B) As of the beginning of the year of change, the taxpayer will adjust its deferred tax reserve account or similar account in the taxpayer's regulatory books of account by the amount of the deferral of federal income tax liability associated with the § 481(a) adjustment applicable to the public utility property subject to the application; and

(C) Within 30 calendar days of filing the federal income tax return for the year of change, the taxpayer will provide a copy of the completed application to any regulatory body having jurisdiction over the public utility property subject to the application.

(b) A taxpayer whose average annual gross receipts, as determined under § 1.263(a)–3(h)(3), for the three preceding taxable years is less than or equal to $10,000,000 ("qualifying taxpayer") is required to complete only the following information on Form 3115:

(i) The identification section of page 1 (above Part I);

(ii) The signature section at the bottom of page 1;

(iii) Part I, line 1(a);

(iv) Part II, all lines except lines 11, 13, 14, 15, and 17;

(v) Part IV, lines 25 and 26; and

(vi) Schedule E, line 3.

(6) *No ruling on asset*. The consent granted under this revenue procedure for a change specified in section 6.40(4)(a) of this APPENDIX is not a determination by the Commissioner that the taxpayer is using the appropriate asset under § 1.168(i)–1(e)(2)(viii) for determining what asset is disposed of by the taxpayer and does not create any presumption that the proposed asset is permissible under § 1.168(i)–1(e)(2)(viii). The director will ascertain whether the taxpayer's determination of its asset under § 1.168(i)–1(e)(2)(viii) is permissible.

(7) *Section 481(a) adjustment period*.

(a) If a taxpayer makes the change specified in section 6.40(4)(a) of this APPENDIX and if the taxpayer recognized a gain or loss under § 1.168(i)–1T or § 1.168(i)–8T, as applicable, on the disposition of a portion of the asset in a taxable year prior to the year of change, the taxpayer must take the entire amount of the § 481(a) adjustment into account in computing taxable income for the year of change.

(b) If section 6.40(7)(a) of this APPENDIX does not apply, see section 5.04 of this revenue procedure for the § 481(a) adjustment period.

(c) *Example*. (i) X, a calendar year taxpayer, acquired and placed in service a building and its structural components in 2000. X depreciates this building and its structural components under § 168. The roof is a structural component of the building. X replaced the entire roof in 2010. On its federal tax return for the taxable year ended December 31, 2010, X did not recognize a loss on the retirement of the original roof and continues to depreciate the original roof. X also capitalized the cost of the replacement roof and has been depreciating this roof under § 168 since June 2010. The adjusted depreciable basis of the original roof at the time of its retirement in 2010 (taking into account the applicable convention) is $11,000, and X claimed depreciation of $1,000 for such roof after its retirement (taking into account the applicable convention) and before the 2012 taxable year. Also the 12-month allowable depreciation deduction for the original roof is $500 for the 2012 taxable year and $500 for the 2013 taxable year.

(ii) In accordance with § 1.168(i)–1T and section 6.32(1)(a) of the APPENDIX to Rev. Proc. 2011–14, as modified by Rev. Proc. 2012–20, 2012–14 I.R.B. 700, X filed with its federal tax return for the taxable year ended December 31, 2012, a Form 3115 to: (1) make a late general asset account election to include the building (including its structural components) placed in service in 2000 in one general asset account and the replacement roof in a separate general asset account; and (2) make a late qualifying disposition election for the retirement of the original roof in 2010. As a result, X removed the original roof from the general asset account and reported a net negative § 481(a) adjustment on this Form 3115 of $10,000 (adjusted depreciable basis of $11,000 for the original roof at the time of its retirement (taking into account the applicable convention) less depreciation of $1,000 claimed for such roof after its retirement (taking into account the applicable convention) and before the 2012 taxable year).

(iii) X complies with § 1.168(i)–1 beginning with its taxable year ending December 31, 2014. In accordance with section 6.40(4)(a) of this APPENDIX, X files a Form 3115 with its 2014 federal income tax return to change to treating the building (including its original roof and other original structural components) placed in service in 2000 as an asset and the replacement roof as a separate asset for disposition purposes. As a result, X must include the original roof that X retired in 2010 in the general asset account. Thus, the net positive § 481(a) adjustment for this change is $9,000 (net loss of $10,000 claimed on the 2012 return for the retirement of the original roof less depreciation of $1,000 for the original roof for 2012 and 2013) and is included in X's taxable income for 2014.

(8) *Concurrent automatic change*.

(a) A taxpayer making this change for more than one asset for the same year of change should file a single Form 3115 for all such assets and provide a single net § 481(a) adjustment for all the changes included in that Form 3115. If one or more of the changes in that single Form 3115 generate a negative § 481(a) adjustment and other changes in that same Form 3115 generate a positive § 481(a) adjustment, the taxpayer may provide a single negative § 481(a) adjustment for all the changes that are included in that Form 3115 generating such negative adjustment and a single positive § 481(a) adjustment for all the changes that are included in that Form 3115 generating such positive adjustment.

(b) A taxpayer making this change and any change listed in this section 6.40(8)(b)(i)–(iv) of the APPENDIX for the same year of change should file a single Form 3115 for all of such changes and must enter the designated automatic accounting method change numbers for the changes on the appropriate line on the Form 3115. For guidance on filing a single application for two or more changes, see section 6.02(1)(b)(ii) of this revenue procedure. The listed changes are:

(i) A change under section 6.01 of this APPENDIX;

(ii) A change under section 6.37 of this APPENDIX;

(iii) A change under section 6.38 of this APPENDIX; and

(iv) A change under section 6.39 of this APPENDIX.

(c) A taxpayer making this change and any change under section 6.32(1)(a)(ii), (iii), (iv), or (v) of this APPENDIX (certain late general asset account elections) or any change listed in this section 6.40(8)(c)(i)–(ii) of the APPENDIX for the same year of change should file a single Form 3115 for all such changes and must enter the designated automatic accounting method change numbers for the changes on the appropriate line on the Form 3115. This section 6.40(8)(c) of the APPENDIX applies only if all of these changes are made for any taxable year beginning on or after January 1, 2012, and beginning before January 1, 2014. For guidance on filing a single application for two or more changes, see section 6.02(1)(b)(ii) of this revenue procedure. The listed changes are:

(i) A change under section 6.01 of this APPENDIX; and

(ii) A change under section 6.37(4)(b) of this APPENDIX.

(9) *Ogden copy of Form 3115 required in lieu of national office copy*. A taxpayer changing its method of accounting under this section 6.40 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 6.02(7)(b) (providing the mailing address) of this revenue procedure.

(10) *Designated automatic accounting method change numbers*. The designated automatic accounting method change number for a change to the method of accounting under section 6.40 of this APPENDIX is "207." *See* section 6.02(4) of this revenue procedure.

(11) *Contact information*. For further information regarding a change under this section, contact Patrick Clinton at (202) 317-7005 (not a toll-free call).

SECTION 4. SUMMARY OF CHANGES IN METHODS OF ACCOUNTING RELATED TO DISPOSITIONS OF MACRS PROPERTY

.01 *Final regulations*. The following chart summarizes the changes in methods of accounting under § 1.167(a)–4, § 1.168(i)–1, § 1.168(i)–7, and § 1.168(i)–8 that a taxpayer may make under Rev. Proc. 2011–14.

FINAL REGULATION SECTION	SECTION # in APPENDIX in REV. PROC. 2011–14	DESIGNATED CHANGE NUMBER (DCN)	FOR MORE INFORMATION SEE
§ 1.167(a)–4, Depreciation of leasehold improvements	6.36	199	Section 3.03(4) of Rev. Proc. 2014–17
General Asset Accounts:			
a. § 1.168(i)–1(c), Change in grouping assets	6.37	200	Section 3.02(7) of Rev. Proc. 2014–54
b. § 1.168(i)–1(e)(2)(viii), Change in determining asset disposed of	6.40	207	Section 3.03(3) of Rev. Proc. 2014–54
c. § 1.168(i)–1(j)(2), Change in method of identifying which assets or portions of assets have been disposed of from one method to another method specified in § 1.168(i)–1(j)(2)	6.37	200	Section 3.02(7) of Rev. Proc. 2014–54
d. § 1.168(i)–1(j)(2), Change in method of identifying which assets or portions of assets have been disposed of from a method not specified in § 1.168(i)–1(j)(2) to a method specified in § 1.168(i)–1(j)(2)	6.40	207	Section 3.03(3) of Rev. Proc. 2014–54
e. § 1.168(i)–1(j)(3), Change in determining unadjusted depreciable basis of disposed asset or disposed portion of an asset from one reasonable method to another reasonable method when it is impracticable from the taxpayer's records to determine the unadjusted depreciable basis of disposed asset or disposed portion of asset	6.37	200	Section 3.02(7) of Rev. Proc. 2014–54
f. § 1.168(i)–1(j)(3), Change in determining unadjusted depreciable basis of disposed asset or disposed portion of an asset from not using to using the taxpayer's records when it is practicable from the taxpayer's records to determine the unadjusted depreciable basis of disposed asset or disposed portion of asset	6.40	207	Section 3.03(3) of Rev. Proc. 2014–54
g. § 1.168(i)–1(j)(3), Change in determining unadjusted depreciable basis of disposed asset or disposed portion of an asset from an unreasonable method to a reasonable method when it is impracticable from the taxpayer's records to determine the unadjusted depreciable basis of disposed asset or disposed portion of asset	6.40	207	Section 3.03(3) of Rev. Proc. 2014–54

FINAL REGULATION SECTION	SECTION # in APPENDIX in REV. PROC. 2011–14	DESIGNATED CHANGE NUMBER (DCN)	FOR MORE INFORMATION SEE
Single Asset Accounts or Multiple Asset Accounts for MACRS Property:			
a. § 1.168(i)–7, Change from single asset accounts to multiple asset accounts, or vice versa	6.37	200	Section 3.03(5) of Rev. Proc. 2014–17, as modified by section 3.02(7) of Rev. Proc. 2014–54
b. § 1.168(i)–7(c), Change in grouping assets in multiple asset accounts	6.37	200	Section 3.03(5) of Rev. Proc. 2014–17, as modified by section 3.02(7) of Rev. Proc. 2014–54
Dispositions of MACRS Property (not in a general asset account):			
	6.38 (Building or structural component)	205	Section 3.03(1) of Rev. Proc. 2014–54
a. § 1.168(i)–8(c)(4), Change in determining asset disposed of	6.39 (Property other than a building or structural component)	206	Section 3.03(2) of Rev. Proc. 2014–54
b. § 1.168(i)–8(f)(2) or (3), Change in determining unadjusted depreciable basis of disposed asset in a multiple asset account or disposed portion of an asset from one reasonable method to another reasonable method when it is impracticable from the taxpayer's records to determine the unadjusted depreciable basis of disposed asset or disposed portion of asset	6.37	200	Section 3.02(7) of Rev. Proc. 2014–54
c. § 1.168(i)–8(f)(2) or (3), Change in determining unadjusted depreciable basis of disposed asset in a multiple asset account or disposed portion of an asset from not using to using the taxpayer's records when it is practicable from the taxpayer's records to determine the unadjusted depreciable basis of disposed asset or disposed portion of asset	6.38 (Building or structural component)	205	Section 3.03(1) of Rev. Proc. 2014–54
	6.39 (Property other than a building or structural component)	206	Section 3.03(2) of Rev. Proc. 2014–54

FINAL REGULATION SECTION	SECTION # in APPENDIX in REV. PROC. 2011–14	DESIGNATED CHANGE NUMBER (DCN)	FOR MORE INFORMATION SEE
d. § 1.168(i)–8(f)(2) or (3), Change in determining unadjusted depreciable basis of disposed asset in a multiple asset account or disposed portion of an asset from an unreasonable method to a reasonable method when it is impracticable from the taxpayer's records to determine the unadjusted depreciable basis of disposed asset or disposed portion of asset	6.38 (Building or structural component)	205	Section 3.03(1) of Rev. Proc. 2014–54
	6.39 (Property other than a building or structural component)	206	Section 3.03(2) of Rev. Proc. 2014–54
e. § 1.168(i)–8(g), Change in method of identifying which assets in a multiple asset account or portions of assets have been disposed of from one method to another method specified in § 1.168(i)–8(g)(1) or (2)	6.37	200	Section 3.02(7) of Rev. Proc. 2014–54
f. § 1.168(i)–8(g), Change in method of identifying which assets in a multiple asset account or portions of assets have been disposed of from a method not specified in § 1.168(i)–8(g)(1) or (2) to a method specified in § 1.168(i)–8(g)(1) or (2)	6.38 (Building or structural component)	205	Section 3.03(1) of Rev. Proc. 2014–54
	6.39 (Property other than a building or structural component)	206	Section 3.03(2) of Rev. Proc. 2014–54
g. § 1.168(i)–8(h)(1), Change from depreciating a disposed asset or disposed portion of an asset to recognizing gain or loss upon disposition when a taxpayer continues to depreciate the asset or portion that the taxpayer disposed of prior to the year of change	6.38 (Building or structural component)	205	Section 3.03(1) of Rev. Proc. 2014–54
	6.39 (Property other than a building or structural component)	206	Section 3.03(2) of Rev. Proc. 2014–54
h. § 1.168(i)–8(d)(2)(iii), Partial disposition election for the disposition of a portion of an asset to which the IRS's adjustment pertains	6.35	198	Section 3.02(6) of Rev. Proc. 2014–54

.02 *Late elections or revocation of a general asset account election*. The following chart summarizes the late elections under § 1.168(i)–1, § 1.168(i)–8, Prop. Reg. § 1.168(i)–1, Prop. Reg. § 1.168(i)–8, or § 1.168(1)–1T that are treated as a change in method of accounting for a limited period of time. The chart includes the revocation of a general asset account election that also is treated as a change in method of accounting for a limited period of time.

ELECTION OR REVOCATION	TIME PERIOD FOR TREATING ELECTION OR REVOCATION AS A METHOD CHANGE	SECTION # IN APPENDIX IN REV. PROC. 2011–14, AND DCN	FOR MORE INFORMATION SEE
General Asset Accounts:			
a. Late general asset account election under § 1.168(i)–1, Prop. Reg. § 1.168(i)–1, or § 1.168(1)–1T	Taxable year beginning on or after 1/1/2012 and beginning before 1/1/2014	6.32 DCN 180	Section 3.02(9) of Rev. Proc. 2014–17, as modified by section 3.02(3) of Rev. Proc. 2014–54
b. Late election to recognize gain or loss upon disposition of all assets, the last asset, or the remaining portion of the last asset under § 1.168(i)–1(e)(3)(ii) or Prop. Reg. § 1.168(i)–1(e)(3)(ii)	Taxable year beginning on or after 1/1/2012 and beginning before 1/1/2014	6.32 DCN 180	Section 3.02(9) of Rev. Proc. 2014–17, as modified by section 3.02(3) of Rev. Proc. 2014–54
c. Late election to recognize gain or loss upon disposition of all assets or the last asset under § 1.168(1)–1T(e)(3)(ii)	Taxable year beginning on or after 1/1/2012 and beginning before 1/1/2014	6.32 DCN 180	Section 3.02(9) of Rev. Proc. 2014–17, as modified by section 3.02(3) of Rev. Proc. 2014–54
d. Late election to recognize gain or loss upon disposition of an asset in a qualifying disposition under § 1.168(i)–1(e)(3)(iii), Prop. Reg. § 1.168(i)–1(e)(3)(iii), or § 1.168(1)–1T(e)(3)(iii)	Taxable year beginning on or after 1/1/2012 and beginning before 1/1/2014	6.32 DCN 180	Section 3.02(9) of Rev. Proc. 2014–17, as modified by section 3.02(3) of Rev. Proc. 2014–54
e. Revocation of a general asset account election made under § 1.168(i)–1, Prop. Reg. § 1.168(i)–1, or § 1.168(1)–1T, or made under section 6.32 in Appendix in Rev. Proc. 2011–14	Taxable year beginning on or after 1/1/2012 and beginning before 1/1/2015	6.34 DCN 197	Section 3.03(2) of Rev. Proc. 2014–17, as modified by section 3.02(5) of Rev. Proc. 2014–54
Late Partial Disposition Election for MACRS Property (not in a general asset account):			
a. Late partial disposition election made under § 1.168(i)–8(d)(2)(iv)(B)	First or second taxable succeeding the applicable taxable year as defined in § 1.168(i)–8(d)(2)(iv)	6.33 DCN 196	Section 3.02(4) of Rev. Proc. 2014–54
b. Other late partial disposition elections made under § 1.168(i)–8(d)(2)(i)	Taxable year beginning on or after 1/1/2012 and beginning before 1/1/2015	6.33 DCN 196	Section 3.02(4) of Rev. Proc. 2014–54
c. Late partial disposition election made under Prop. Reg. § 1.168(i)–8(d)(2)(iv)(B)	First or second taxable succeeding the applicable taxable year as defined in Prop. Reg. § 1.168(i)–8(d)(2)(iv)	6.33 DCN 196	Section 3.03(1) of Rev. Proc. 2014–17, as modified by section 3.02(4) of Rev. Proc. 2014–54
d. Other late partial disposition elections made under Prop. Reg. § 1.168(i)–8(d)(2)(i)	Taxable year beginning on or after 1/1/2012 and beginning before 1/1/2014	6.33 DCN 196	Section 3.03(1) of Rev. Proc. 2014–17, as modified by section 3.02(4) of Rev. Proc. 2014–54

.03 *Temporary and proposed regulations*. If a taxpayer applies § 1.167(a)–4T, § 1.168(i)–1T, § 1.168(i)–7T, § 1.168(i)–8T, Prop. Reg. § 1.168(i)–1, Prop. Reg. § 1.168(i)–7, or Prop. Reg. § 1.168(i)–8 for a taxable year beginning on or after January 1, 2012, and beginning before January 1, 2014, the following chart summarizes the changes in methods of accounting under those regulation sections that the taxpayer may make under Rev. Proc. 2011–14.

TEMPORARY OR PROPOSED REGULATION SECTION	SECTION # in APPENDIX in REV. PROC. 2011–14	DCN	FOR MORE INFORMATION SEE
§ 1.167(a)–4T, Depreciation of leasehold improvements	6.27	175	Section 3.02(4) of Rev. Proc. 2014–17
General Asset Accounts:			
a. § 1.168(i)–1T(c) or Prop. Reg. § 1.168(i)–1(c), Change in grouping assets	6.28	176	Section 3.02(5) of Rev. Proc. 2014–17
b. § 1.168(i)–1T(e)(2)(viii) or Prop. Reg. § 1.168(i)–1(e)(2)(viii), Change in determining asset disposed of	6.31	179	Section 3.02(8) of Rev. Proc. 2014–17
c. § 1.168(i)–1T(j)(2) or Prop. Reg. § 1.168(i)–1(j)(2), Change in method of identifying which assets have been disposed of from one method to another method specified in § 1.168(i)–1T(j)(2), or from one method to another method specified in Prop. Reg. § 1.168(i)–1(j)(2)	6.28	176	Section 3.02(5) of Rev. Proc. 2014–17
d. § 1.168(i)–1T(j)(2) or Prop. Reg. § 1.168(i)–1(j)(2), Change in method of identifying which assets have been disposed of from a method not specified in § 1.168(i)–1T(j)(2) to a method specified in § 1.168(i)–1T(j)(2), or from a method not specified in Prop. Reg. § 1.168(i)–1(j)(2) to a method specified in Prop. Reg. § 1.168(i)–1(j)(2)	6.31	179	Section 3.02(8) of Rev. Proc. 2014–17
e. § 1.168(i)–1T(j)(3), Change in determining unadjusted depreciable basis of disposed asset from one reasonable method to another reasonable method	6.28	176	Section 3.02(5) of Rev. Proc. 2014–17
f. Prop. Reg. § 1.168(i)–1(j)(3), Change in determining unadjusted depreciable basis of disposed asset or disposed portion of an asset from one reasonable method to another reasonable method	6.28	176	Section 3.02(5) of Rev. Proc. 2014–17
Single Asset Accounts or Multiple Asset Accounts for MACRS Property:			
a. § 1.168(i)–7T or Prop. Reg. § 1.168(i)–7, Change from single asset accounts to multiple asset accounts, or vice versa	6.28	176	Section 3.02(5) of Rev. Proc. 2014–17
b. § 1.168(i)–7T(c), Change in grouping assets in multiple asset accounts	6.28	176	Section 3.02(5) of Rev. Proc. 2014–17
Dispositions of MACRS Property (not in a general asset account):			
a. § 1.168(i)–8T(c)(4) or Prop. Reg. § 1.168(i)–8(c)(4), Change in determining asset disposed of	6.29 (Building or structural component)	177	Section 3.02(6) of Rev. Proc. 2014–17, as modified by section 3.02(2) of Rev. Proc. 2014–54
	6.30 (Property other than a building or structural component)	178	Section 3.02(7) of Rev. Proc. 2014–17

TEMPORARY OR PROPOSED REGULATION SECTION	SECTION # in APPENDIX in REV. PROC. 2011–14	DCN	FOR MORE INFORMATION SEE
b. § 1.168(i)–8T(e)(2) or Prop. Reg. § 1.168(i)–8(f)(2), Change in determining unadjusted depreciable basis of disposed asset in a multiple asset account from one reasonable method to another reasonable method when it is impracticable from the taxpayer's records to determine the unadjusted depreciable basis of disposed asset	6.28	176	Section 3.02(5) of Rev. Proc. 2014–17
c. Prop. Reg. § 1.168(i)–8(f)(3), Change in determining unadjusted depreciable basis of disposed portion of an asset from one reasonable method to another reasonable method	6.28	176	Section 3.02(5) of Rev. Proc. 2014–17
d. § 1.168(i)–8T(f) or Prop. Reg. § 1.168(i)–8(g), Change in method of identifying which assets in a multiple asset account have been disposed of from one method to another method specified in § 1.168(i)–8T(f)(1) or (2), or from one method to another method specified in Prop. Reg. § 1.168(i)–8(g)(1) or (2)	6.28	176	Section 3.02(5) of Rev. Proc. 2014–17
e. § 1.168(i)–8T(f) or Prop. Reg. § 1.168(i)–8(g), Change in method of identifying which assets in a multiple asset account have been disposed of from a method not specified in § 1.168(i)–8T(f)(1) or (2) to a method specified in § 1.168(i)–8T(f)(1) or (2), or from a method not specified in Prop. Reg. § 1.168(i)–8(g)(1) or (2) to a method specified in Prop. Reg. § 1.168(i)–8(g)(1) or (2)	6.29 (Building or structural component)	177	Section 3.02(6) of Rev. Proc. 2014–17, as modified by section 3.02(2) of Rev. Proc. 2014–54
	6.30 (Property other than a building or structural component)	178	Section 3.02(7) of Rev. Proc. 2014–17
f. § 1.168(i)–8T(g)(1) or Prop. Reg. § 1.168(i)–8(h)(1), Change from depreciating a disposed asset or disposed portion of an asset to recognizing gain or loss upon disposition when a taxpayer continues to depreciate the asset or portion that the taxpayer disposed of prior to the year of change	6.29 (Building or structural component)	177	Section 3.02(6) of Rev. Proc. 2014–17, as modified by section 3.02(2) of Rev. Proc. 2014-54
	6.30 (Property other than a building or structural component)	178	Section 3.02(7) of Rev. Proc. 2014–17
g. Prop. Reg. § 1.168(i)–8(d)(2)(iii), Partial disposition election for the disposition of a portion of an asset to which the IRS's adjustment pertains	6.35	198	Section 3.03(3) of Rev. Proc. 2014–17, as modified by section 3.02(6) of Rev. Proc. 2014-54

SECTION 5. EFFECTIVE DATE

.01 *In general*. This revenue procedure is effective September 18, 2014.

.02 *Transition rules*. The following transition rules apply:

(1) *Form 3115 filed under Rev. Proc. 97–27*.

(a) *Conversion to change under this revenue procedure*. If before September 18, 2014, a taxpayer properly filed a Form 3115 under Rev. Proc. 97–27, 1997–1 C.B. 680, requesting consent for a change in method of accounting described in section 3 of this revenue procedure, and the Form 3115 is pending with the national office on September 18, 2014, the taxpayer may choose to make the change under this revenue procedure if the taxpayer is otherwise eligible under this revenue procedure. The taxpayer must notify the national office of its intent to make the change under this revenue procedure prior to the issuance of a letter ruling granting or denying consent for the change. If the taxpayer timely notifies the national office that it will make the change under this revenue procedure, the national office ordinarily will return the Form 3115 to the taxpayer to make the necessary modifications to comply with the applicable provisions of this revenue procedure and will refund the user fee submitted with the Form 3115.

(b) *Filing requirements*. A Form 3115 that is returned to the taxpayer for necessary modifications will be converted to a Form 3115 under this revenue procedure if the taxpayer resubmits the Form 3115 with the necessary modifications, along with a copy of the national office letter sent with the returned Form 3115, to the IRS in Ogden, UT (mailing address is provided in section 5.02(2)(c)(iv) of this revenue procedure) within the later of (a) the due date specified in section 6.02(3) of Rev. Proc. 2011–14, or (b) 30 calendar days after the date of the IRS's letter returning the Form 3115 to the taxpayer.

(2) *Form 3115 filed under Rev. Proc. 2014–17*.

(a) *Scope*. This section 5.02(2) applies to a taxpayer that properly filed a Form 3115 to make a change in method of accounting under Rev. Proc. 2014–17, 2014–12 I.R.B. 661, to:

(i) Apply § 1.168(i)–1T, § 1.168(i)–7T, § 1.168(i)–8T, Prop. Reg. § 1.168(i)–1, Prop. Reg. § 1.168(i)–7, or Prop. Reg. § 1.168(i)–8, for a taxable year beginning on or after January 1, 2012, and beginning before January 1, 2014; or

(ii) Apply § 1.168(i)–7 for a taxable year beginning on or after January 1, 2012.

(b) *General rule*. If a taxpayer within the scope of this section 5.02(2) properly filed the Form 3115 with the IRS in Ogden, UT (Ogden Copy) under Rev. Proc. 2014–17 to make a change in method of accounting described in section 3.02(5) (permissible to permissible method of accounting for depreciation of MACRS property under § 1.168(i)–7T or Prop. Reg. § 1.168(i)–7), 3.02(9) (late general asset account elections), 3.03(1) (late partial disposition election), 3.03(2) (revocation of a general asset account election), 3.03(3) (partial dispositions of tangible depreciable assets to which the IRS's adjustment pertains), or 3.03(5) (permissible to permissible method of accounting for depreciation of MACRS property under § 1.168(i)–7) of Rev. Proc. 2014–17 and the Form 3115 was either post-marked or received by the IRS on or before September 18, 2014, the taxpayer makes the change under Rev. Proc. 2014–17.

(c) *Option to file an amended Form 3115*. If on or before September 18, 2014, a taxpayer within the scope of this section 5.02(2) properly filed a Form 3115 under Rev. Proc. 2014–17, the taxpayer may choose to file an amended Form 3115 under this revenue procedure for the same year of change on the Form 3115 filed under Rev. Proc. 2014–17 if, on or before December 31, 2014, the taxpayer (i) files an amended federal income tax return using the new method of accounting pursuant to this revenue procedure, (ii) attaches the original of the amended Form 3115 filed under this revenue procedure to its amended federal income tax return for the year of change, (iii) writes on the top of page 1 of the Ogden Copy of the amended Form 3115 "FILED UNDER SECTION 5.02(2) OF REV. PROC. 2014–54"; and (iv) sends the Ogden Copy of the amended Form 3115 to the following address no later than the date the amended Form 3115 is filed with the amended federal income tax return: Internal Revenue Service, 1973 North Rulon White Blvd., Mail Stop 4917, Ogden, UT 84404.

SECTION 6. EFFECT ON OTHER DOCUMENTS

.01 Rev. Proc. 2011–14 is modified and clarified.

.02 Sections 3.02(6), 3.02(9), 3.03(1), 3.03(2), and 3.03(5) of Rev. Proc. 2014–17 are modified.

.03 Section 3.02(1) of Rev. Proc. 2014–16 is modified.

SECTION 7. PAPERWORK REDUCTION ACT

The collection of information contained in this revenue procedure has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545–1551. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid OMB control number.

The collections of information in this revenue procedure are in sections 3.03 and 5.02(2)(c) of this revenue procedure. This information is necessary and will be used to determine whether the taxpayer properly changed to a permitted method of accounting. The collections of information are required for a taxpayer to obtain consent to change its method of accounting. The likely respondents are the following: individuals, farms, business or other for-profit institutions, nonprofit institutions, and small businesses or organizations.

The estimated total annual reporting and/or recordkeeping burden is 1,200 hours.

The estimated annual burden per respondent/recordkeeper varies from ¼ hour to 1.5 hours, depending on individual circumstances, with an estimated average of ¾ hour. The estimated number of respondents is 1,600. The estimated annual frequency of responses is on occasion.

SECTION 8. DRAFTING INFORMATION

The principal author of this revenue procedure is Kathleen Reed of the Office of Associate Chief Counsel (Income Tax & Accounting). For further information regarding this revenue procedure, contact Patrick Clinton of the Office of Associate Chief Counsel (Income Tax & Accounting) at (202) 317-7005 (not a toll free number).

Part IV. Items of General Interest

Notice of Proposed Rulemaking Removal of Allocation Rule for Disbursements from Designated Roth Accounts to Multiple Destinations

REG–105739–11

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed amendments to the regulations that address the tax treatment of distributions from designated Roth accounts under tax-favored retirement plans. The proposed regulations would limit the applicability of the rule regarding the allocation of after-tax amounts when disbursements are made to multiple destinations so the allocation rule applies only to distributions made before the earlier of January 1, 2015 or a date chosen by the taxpayer that is on or after September 18, 2014. These regulations would affect administrators of, employers maintaining, participants in, and beneficiaries of designated Roth accounts under tax-favored retirement plans.

DATES: Written or electronic comments and requests for a public hearing must be received by December 18, 2014.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–105739–11), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington D.C. 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–105739–11), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C., or sent electronically via the Federal eRulemaking Portal at *http://www.regulations.gov* (IRS REG–105739–11).

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Michael P. Brewer at (202) 317-6700; concerning submission of comments or to requests for a public hearing, Oluwafunmilayo (Funmi) Taylor at (202) 317-6901 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

Section 402(a) provides generally that any amount distributed from a trust described in section 401(a) that is exempt from tax under section 501(a) is taxable to the distributee under section 72 in the taxable year of the distributee in which distributed. Under section 403(b)(1), any amount distributed from a section 403(b) plan is also taxable to the distributee under section 72.

If a participant's account balance in a plan qualified under section 401(a) or in a section 403(b) plan includes both after-tax and pretax amounts, then, under section 72(e)(8), each distribution (other than a distribution that is paid as part of an annuity) from the plan will include a pro rata share of both after-tax and pretax amounts. (Under section 72(d), a different allocation method applies to annuity distributions.)

Under section 402A(d)(4), section 72 is applied separately with respect to distributions and payments from a designated Roth account and other distributions and payments from the plan.

Section 402(c) prescribes rules for amounts that are rolled over from qualified trusts to eligible retirement plans, including individual retirement accounts or annuities ("IRAs"). Subject to certain exceptions, section 402(c)(1) provides that if any portion of an eligible rollover distribution paid to an employee from a qualified trust is transferred to an eligible retirement plan, the portion of the distribution so transferred is not includible in gross income in the taxable year in which paid.

Under section 402(c)(2), the maximum portion of an eligible rollover distribution that may be rolled over in a transfer to which section 402(c)(1) applies generally cannot exceed the portion of the distribution that is otherwise includible in gross income. However, under section 402(c)(2)(A) and (B), the general rule does not apply to such a distribution to the extent that such portion is transferred in a direct trustee-to-trustee transfer to a qualified trust or to an annuity contract described in section 403(b) and such trust or contract provides for separate accounting for amounts so transferred (and earnings thereon), including separately accounting for the portion of such distribution which is includible in gross income and the portion of such distribution which is not so includible, or such portion is transferred to an IRA.

In addition, section 402(c)(2) prescribes that, in the case of a transfer described in subparagraph (A) or (B), the amount transferred shall be treated as consisting first of the portion of such distribution that is includible in gross income (determined without regard to section 402(c)(1)).

Under section 402A, an applicable retirement plan may include a designated Roth account. An applicable retirement plan is defined in section 402A(e)(1) to mean a plan qualified under section 401(a), a section 403(b) plan, and a governmental section 457(b) plan. Section 402A(d) provides that a qualified distribution (as defined in section 402A(d)(2)) from a designated Roth account is not includible in gross income.

Section 1.402A–1, Q&A–5(a), of the Income Tax Regulations prescribes taxability rules for a distribution from a designated Roth account that is rolled over. Q&A–5(a) provides, in part, that "any amount paid in a direct rollover is treated as a separate distribution from any amount paid directly to the employee."

Section 402(f) requires that the plan administrator of a plan qualified under section 401(a) provide any recipient of an eligible rollover distribution with a written explanation describing certain provisions of law. Notice 2009–68, 2009–2 CB 423 (September 28, 2009), contains two safe harbor explanations that may be provided to recipients of eligible rollover distributions from an employer plan in order to satisfy section 402(f). The safe harbor explanation with respect to distributions that are not from a designated Roth account provides in part (under the heading "If your payment includes after-tax contributions") that "[i]f you do a direct rollover of only a portion of the amount paid from the Plan and a portion is paid to you, each of the payments will include an allocable portion of the after-tax contributions." Similarly, for distributions from a designated Roth account, the safe harbor explanation provides in part (under the heading "How Do I Do a Rollover?") that "[i]f you do a direct rollover of only a portion of the amount paid from the Plan and a portion is paid to you, each of the payments will include an allocable portion of the earnings in your designated Roth account."

Sections 403(b)(8)(B) and 457(e)(16)(B) provide that the rules of section 402(c)(2) through (7), (9), and (11) and the rules of section 402(f) also apply to section 403(b) plans and governmental section 457(b) plans.

In response to Notice 2009–68, comments were received requesting changes to the rules regarding the allocation of basis among simultaneous disbursements to multiple destinations from a retirement plan that contains both after-tax and pretax amounts. Commenters indicated that some plan providers were treating disbursements to separate destinations not as separate distributions but rather as a single distribution of the aggregate disbursement amounts. These plan providers permitted allocation of all the after-tax amounts included in the disbursements to a Roth IRA. The commenters also pointed out that, even under the allocation method described in Notice 2009–68, a participant who wishes to disburse after-tax amounts to one destination and pretax amounts to another could accomplish this result in a series of steps. First, the participant could take an eligible rollover distribution as a single cash distribution. Second, by taking advantage of the rule in section 402(c)(2) that distribution amounts that are rolled over are treated as consisting first of pretax amounts, the participant could roll over the pretax amounts included in the distribution to one destination, such as a traditional IRA. The remaining amount of the distribution would be after-tax, which the participant could either roll over into a Roth IRA or retain without incurring any tax liability. The option to roll over all after-tax amounts into a Roth IRA, however, would be available only to taxpayers with sufficient funds available outside of the plan to be able to roll over the entire amount distributed, including an amount equal to the 20 percent of the taxable portion of the distribution that is required to be paid to the IRS as withholding pursuant to § 3405(c).

These proposed regulations are being issued in conjunction with Notice 2014–54 (to be published in IRB 2014–41 (October 6, 2014)), which will permit a taxpayer to direct after-tax and pretax amounts that are simultaneously disbursed to multiple destinations so as to allocate them to specific destinations. Taxpayers will be able to direct these allocations in connection with disbursements that are directly rolled over, not only in connection with 60-day rollovers after receiving a distribution.

Explanation of Provisions

The proposed regulations would limit the applicability of the existing requirement in §1.402A–1, Q&A–5(a), that "any amount paid in a direct rollover is treated as a separate distribution from any amount paid directly to the employee." Under the proposed regulations, that separate distribution requirement would not apply to distributions made on or after January 1, 2015, or an earlier date chosen by the taxpayer. An earlier date chosen by the taxpayer for this purpose may not be earlier than September 18, 2014. See the "Proposed Effective Date" section of this preamble for a description of the rules that will apply after the separate distribution rule of §1.402A–1, Q&A–5(a), no longer applies to distributions.

Proposed Effective Date

These regulations are proposed to apply to distributions from designated Roth accounts made on or after January 1, 2015. For distributions from designated Roth accounts made on or after the applicability date of the Treasury decision that finalizes these proposed regulations (but no earlier than January 1, 2015), the rules in section III of Notice 2014–54 will apply.

For distributions that are made on or after September 18, 2014 and before the applicability date of the Treasury decision that finalizes these proposed regulations, taxpayers may rely on these proposed regulations. Taxpayers relying on these proposed regulations should apply a reasonable interpretation of the last sentence of section 402(c)(2) to allocate after-tax and pretax amounts among disbursements made to multiple destinations. For this purpose, a reasonable interpretation of the last sentence of section 402(c)(2) includes the rules issued by the IRS in section III of Notice 2014–54.

Statement of Availability of IRS Documents

The IRS notices cited in this preamble are published in the Internal Revenue Bulletin or Cumulative Bulletin and are available from the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402, or by visiting the IRS website at http://www.irs.gov.

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 regulation does 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 Internal Revenue Code, these regulations have been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their 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 submitted timely to the IRS. The Treasury Department and the IRS specifically request comments on the clarity of the proposed regulations and how they may be made easier to understand.

All comments will be available for public inspection and copying at *www.regulations.gov* or upon request. 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 hearing will be published in the **Federal Register**.

Drafting Information

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

* * * * *

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 1.402A–1 is amended by adding a sentence after the third sentence of paragraph A–5. (a) to read as follows:

§ 1.402A–1 Designated Roth Accounts.

* * * * *

A–5. (a) * * * The preceding sentence does not apply to distributions made on or after January 1, 2015; in addition, a taxpayer may elect not to apply the preceding sentence to distributions made on or after an earlier date that is no earlier than September 18, 2014. * * *

* * * * *

John Dalrymple,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on September 18, 2014, 8:45 a.m., and published in the issue of the Federal Register for September 19, 2014, 79 F.R. 56310)

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.

Numerical Finding List[1]

Bulletins 2014–27 through 2014–41

Announcements:

2014-2, 2014-28 I.R.B. *120*
2014-28, 2014-34 I.R.B. *391*
2014-29, 2014-35 I.R.B. *452*

Notices:

2014-40, 2014-27 I.R.B. *100*
2014-41, 2014-27 I.R.B. *97*
2014-42, 2014-34 I.R.B. *387*
2014-43, 2014-31 I.R.B. *249*
2014-44, 2014-32 I.R.B. *270*
2014-45, 2014-34 I.R.B. *388*
2014-46, 2014-36 I.R.B. *520*
2014-47, 2014-36 I.R.B. *522*
2014-48, 2014-36 I.R.B. *523*
2014-49, 2014-41 I.R.B. *665*
2014-50, 2014-40 I.R.B. *590*
2014-51, 2014-40 I.R.B. *594*
2014-54, 2014-41 I.R.B. *670*
2014-55, 2014-41 I.R.B. *672*
2014-56, 2014-41 I.R.B. *674*

Proposed Regulations:

REG-104579-13, 2014-33 I.R.B. *370*
REG-120756-13, 2014-31 I.R.B. *252*
REG-105067-14, 2014-34 I.R.B. *391*
REG-110948-14, 2014-30 I.R.B. *239*
REG-121542-14, 2014-28 I.R.B. *119*
REG-107012-14, 2014-33 I.R.B. *371*
REG-123286-14, 2014-33 I.R.B. *377*
REG-209459-78, 2014-31 I.R.B. *253*
REG-129507-14, 2014-38 I.R.B. *561*
REG-129786-14, 2014-38 I.R.B. *562*
REG-105739-11, 2014-41 I.R.B. *704*

Revenue Procedures:

2014-26, 2014-27 I.R.B. *26*
2014-27, 2014-27 I.R.B. *41*
2014-29, 2014-28 I.R.B. *105*
2014-37, 2014-33 I.R.B. *363*
2014-38, 2014-29 I.R.B. *132*
2014-39, 2014-29 I.R.B. *151*
2014-40, 2014-30 I.R.B. *229*
2014-41, 2014-33 I.R.B. *364*
2014-42, 2014-29 I.R.B. *193*
2014-43, 2014-32 I.R.B. *273*
2014-44, 2014-32 I.R.B. *274*
2014-45, 2014-34 I.R.B. *388*
2014-46, 2014-33 I.R.B. *367*
2014-47, 2014-35 I.R.B. *393*
2014-48, 2014-36 I.R.B. *527*
2014-49, 2014-37 I.R.B. *535*
2014-50, 2014-37 I.R.B. *540*

Revenue Procedures—Continued:

2014-51, 2014-37 I.R.B. *543*
2014-52, 2014-38 I.R.B. *560*
2014-53, 2014-39 I.R.B. *573*
2014-54, 2014-41 I.R.B. *675*

Revenue Rulings:

2014-14, 2014-27 I.R.B. *12*
2014-19, 2014-32 I.R.B. *266*
2014-20, 2014-28 I.R.B. *101*
2014-21, 2014-34 I.R.B. *381*
2014-22, 2014-37 I.R.B. *523*
2014-23, 2014-40 I.R.B. *575*
2014-24, 2014-37 I.R.B. *529*
2014-25, 2014-40 I.R.B. *574*
2014-26, 2014-41 I.R.B. *663*

Treasury Decisions:

9664, 2014-32 I.R.B. *254*
9668, 2014-27 I.R.B. *1*
9669, 2014-28 I.R.B. *103*
9670, 2014-29 I.R.B. *121*
9671, 2014-29 I.R.B. *124*
9672, 2014-30 I.R.B. *196*
9673, 2014-30 I.R.B. *212*
9674, 2014-30 I.R.B. *225*
9675, 2014-31 I.R.B. *242*
9676, 2014-32 I.R.B. *260*
9677, 2014-31 I.R.B. *241*
9678, 2014-32 I.R.B. *262*
9679, 2014-32 I.R.B. *267*
9680, 2014-32 I.R.B. *254*
9681, 2014-33 I.R.B. *340*
9682, 2014-33 I.R.B. *342*
9683, 2014-33 I.R.B. *330*
9684, 2014-33 I.R.B. *345*
9685, 2014-34 I.R.B. *379*
9686, 2014-34 I.R.B. *382*
9687, 2014-36 I.R.B. *486*
9688, 2014-36 I.R.B. *482*
9689, 2014-36 I.R.B. *456*
9690, 2014-38 I.R.B. *548*
9691, 2014-38 I.R.B. *547*
9692, 2014-40 I.R.B. *574*
9693, 2014-41 I.R.B. *596*
9694, 2014-41 I.R.B. *626*

[1]A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2014–01 through 2014–26 is in Internal Revenue Bulletin 2014–26, dated June 30, 2014.

Finding List of Current Actions on Previously Published Items[1]

Bulletins 2014–27 through 2014–41

Announcements:

2012-11
Supplemented by
Ann. 2014-2, 2014-28 I.R.B. *120*

2013-11
Supplemented by
Ann. 2014-2, 2014-28 I.R.B. *120*

2010-41
Obsoleted by
Rev. Proc. 2014-43, 2014-32 I.R.B. *273*

Revenue Procedures:

1981-38
Superseded by
Rev. Proc. 2014-42, 2014-29 I.R.B. *193*

93-37
Modified and Superseded by
Rev. Proc. 2014-43, 2014-32 I.R.B. *273*

1981-38
Modified by
Rev. Proc. 2014-42, 2014-29 I.R.B. *193*

2000-12
Superseded by
Rev. Proc. 2014-39, 2014-29 I.R.B. *151*

2002-55
Revoked by
Rev. Proc. 2014-39, 2014-29 I.R.B. *151*

2003-64
Superseded by
Rev. Proc. 2014-47, 2014-35 I.R.B. *393*

2004-21
Superseded by
Rev. Proc. 2014-47, 2014-35 I.R.B. *393*

2005-77
Superseded by
Rev. Proc. 2014-47, 2014-35 I.R.B. *393*

2011-14
Modified by
Rev. Proc. 2014-48, 2014-36 I.R.B. *527*

2011-14
Modified by
Rev. Proc. 2014-54, 2014-41 I.R.B. *675*

Revenue Procedures—Continued:

2011-16
Superseded by
Rev. Proc. 2014-51, 2014-37 I.R.B. *543*

2011-16
Modified by
Rev. Proc. 2014-51, 2014-51 I.R.B. *543*

2012-38
Superseded by
Rev. Proc. 2014-27, 2014-27 I.R.B. *26*

2012-46
Superseded by
Rev. Proc. 2014-26, 2014-27 I.R.B. *41*

2014-4
Amplified by
Rev. Proc. 2014-40, 2014-30 I.R.B. *229*

2014-4
Modified by
Rev. Proc. 2014-54, 2014-41 I.R.B. *675*

2014-5
Amplified by
Rev. Proc. 2014-40, 2014-30 I.R.B. *229*

2014-8
Amplified by
Rev. Proc. 2014-40, 2014-30 I.R.B. *229*

2014-9
Amplified by
Rev. Proc. 2014-40, 2014-30 I.R.B. *229*

2014-10
Amplified by
Rev. Proc. 2014-40, 2014-30 I.R.B. *229*

2014-13
Modified by
Rev. Proc. 2014-38, 2014-29 I.R.B. *132*

2014-13
Superseded by
Rev. Proc. 2014-38, 2014-29 I.R.B. *132*

2014-16
Superseded by
Rev. Proc. 2014-51, 2014-37 I.R.B. *543*

2014-16
Modified by
Rev. Proc. 2014-51, 2014-37 I.R.B. *543*

2014-12
Modified by
Rev. Proc. 2014-54, 2014-41 I.R.B. *675*

2014-17
Modified by
Rev. Proc. 2014-54, 2014-41 I.R.B. *675*

Revenue Rulings:

2008-40
Modified by
Rev. Rul. 2014-24, 2014-37 I.R.B. *529*

2011-1
Modified by
Rev. Rul. 2014-24, 2014-37 I.R.B. *529*

2012-6
Modified by
Rev. Rul. 2014-24, 2014-37 I.R.B. *529*

Notices:

2013-11
Modified by
Notice 2014-48, 2014-36 I.R.B. *523*

2013-23
Modified by
Notice 2014-48, 2014-36 I.R.B. *523*

2013-28
Modified by
Notice 2014-48, 2014-36 I.R.B. *523*

2013-29
Modified by
Notice 2014-46, 2014-36 I.R.B. *520*

2013-29
Clarified by
Notice 2014-46, 2014-36 I.R.B. *520*

2013-32
Modified by
Notice 2014-48, 2014-36 I.R.B. *523*

2013-37
Modified by
Notice 2014-48, 2014-36 I.R.B. *523*

2013-51
Obsoleted by
Notice 2014-42, 2014-34 I.R.B. *387*

2013-60
Modified by
Notice 2014-46, 2014-36 I.R.B. *520*

2013-60
Clarified by
Notice 2014-46, 2014-36 I.R.B. *520*

2014-44
Supplemented by
Notice 2014-45, 2014-34 I.R.B. *388*

[1]A cumulative list of current actions on previously published items in Internal Revenue Bulletins 2014–01 through 2014–26 is in Internal Revenue Bulletin 2014–26, dated June 30, 2014.

Treasury Decisions:

2005-47
Obsoleted by
T.D. 9668 2014-27 I.R.B. *1*

2010-51
Obsoleted by
T.D. 9684 2014-33 I.R.B. *345*

2010-71
Obsoleted by
T.D. 9684 2014-33 I.R.B. *345*

2011-6
Obsoleted by
T.D. 9684 2014-33 I.R.B. *345*

2011-9
Obsoleted by
T.D. 9684 2014-33 I.R.B. *345*

INDEX

Internal Revenue Bulletins 2014–27 through 2014–41

The abbreviation and number in parenthesis following the index entry refer to the specific item; numbers in roman and italic type following the parentheses refer to the Internal Revenue Bulletin in which the item may be found and the page number on which it appears.

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

ADMINISTRATIVE

ADMINISTRATIVE—Cont.

EMPLOYEE PLANS

EMPLOYMENT TAX

EMPLOYMENT TAX—Cont.

ESTATE TAX

EXCISE TAX

EXCISE—Cont.

EXEMPT ORGANIZATIONS

GIFT TAX

INCOME TAX—Cont.

SELF-EMPLOYMENT TAX

SPECIAL ANNOUNCEMENT

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