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26 CFR Part 1

The \$500,000 Deduction Limitation for Remuneration Provided by Certain Health Insurance Providers; Proposed Rule

**DEPARTMENT OF THE TREASURY****Internal Revenue Service****26 CFR Part 1**

[REG-106796-12]

RIN 1545-BK88

**The \$500,000 Deduction Limitation for Remuneration Provided by Certain Health Insurance Providers****AGENCY:** Internal Revenue Service (IRS), Treasury.**ACTION:** Notice of proposed rulemaking.

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

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

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

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

**SUPPLEMENTARY INFORMATION:****Background**

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

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

Notice 2011-2 requested comments on the following issues:

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

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

**Explanation of Provisions**

For taxable years beginning after December 31, 2012, section 162(m)(6) limits to \$500,000 the allowable deduction for the aggregate applicable individual remuneration and deferred deduction remuneration attributable to services performed by an applicable

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

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

The following example illustrates the application of the section 162(m)(6) deduction limitation. In Year 1, a covered health insurance provider pays \$400,000 in salary (applicable individual remuneration) to an applicable individual and also credits \$300,000 to an account for the applicable individual under a nonqualified deferred compensation plan, which is payable in Year 5 (deferred deduction remuneration). The \$300,000 credit is fully vested in Year 1 and is attributable to services provided by the applicable individual in that year. In Year 1, the covered health insurance provider may deduct the \$400,000 of applicable individual remuneration paid to the applicable individual for services provided during that year because the amount of this payment is less than the \$500,000 deduction limit. In Year 5, the covered health insurance provider pays the \$300,000 that was credited under the nonqualified deferred compensation

plan for services provided by the applicable individual in Year 1. Because the aggregated applicable individual remuneration and deferred deduction attributable to services performed by the applicable individual in Year 1 exceeds the \$500,000 deduction limit by \$200,000 (\$400,000 + \$300,000 = \$700,000), the covered health insurance provider can deduct only \$100,000 of the \$300,000 payment in year 5, and the remaining \$200,000 is not deductible by the covered health insurance provider in any year.

## I. Covered Health Insurance Provider

### A. In General

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

### B. Health Insurance Issuers

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

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

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

For members of an aggregated group that have different taxable years, these proposed regulations provide rules to determine whether a member of an aggregated group that is not a health insurance issuer is a covered health insurance provider for a particular taxable year. Under these rules, the parent entity (as defined in the following paragraph of this preamble) of an aggregated group is a covered health insurance provider for its taxable year with which, or in which, ends the taxable year of the health insurance issuer that is a covered health insurance provider in the aggregated group of which the parent entity is a member. Each other member of an aggregated group is a covered health insurance provider for its taxable year that ends with, or within, the taxable year of the parent entity during which the parent entity is a covered health insurance provider. For purposes of these proposed regulations, the term *parent entity* refers to the common parent of an aggregated group that is a parent-

subsidiary controlled group of corporations (within the meaning of section 414(b)) or a parent-subsidiary group of trades or businesses under common control (within the meaning of section 414(c)). With respect to an aggregated group that is an affiliated service group within the meaning of section 414(m) or other group within the meaning of section 414(o), the parent entity is the health insurance issuer in the aggregated group if the aggregated group includes only one health insurance issuer. If an aggregated group that is an affiliated service group within the meaning of section 414(m) or other group within the meaning of section 414(o) includes more than one health insurance issuer, the parent entity is any health insurance issuer in the aggregated group that is designated in writing by the other members of the group as the parent entity for purposes of section 162(m)(6), provided that the members of the group treat the health insurance issuer as the parent entity consistently for all taxable years. If the members of an aggregated group that is an affiliated service group or other group fail to designate a parent entity in writing (or fail to apply the designation consistently for all taxable years), the members of the group are deemed to have a parent entity with a taxable year that is the calendar year. A health insurance issuer that has been designated as the parent entity of an aggregated group may leave that group as a result of a merger, disposition, or other corporate transaction; the Treasury Department and the IRS request comments on the circumstances under which a successor parent entity may be designated and any transition rules that may be necessary in this situation.

### D. Self-insurers

In response to a request for comments in Notice 2011-2, commenters suggested that an employer that sponsors a self-insured medical reimbursement plan should not be treated as a covered health insurance provider because benefits under this type of plan should not be treated as health insurance coverage for purposes of section 162(m)(6) if the employer assumes the financial risk of providing health benefits to its employees and limits the availability of benefits only to employees (which may include former employees). The Treasury Department and the IRS agree that an employer should not be treated as a covered health insurance provider under these circumstances. Accordingly, these proposed regulations provide that an employer is not a covered health

insurance provider solely because it maintains a self-insured medical reimbursement plan. For this purpose, the term *self-insured medical reimbursement plan* means a separate written plan for the benefit of employees (which may include former employees) that provides for reimbursement of employee medical expenses referred to in section 105(b) and that does not provide for reimbursement under an individual or group policy of accident or health insurance issued by a licensed insurance company or under an arrangement in the nature of a prepaid health care plan that is regulated under federal or state law in a manner similar to the regulation of insurance companies. An arrangement described in the prior sentence may include a plan maintained by an employee organization described in section 501(c)(9). A captive insurance company, however, is treated as a covered health insurance provider under these proposed regulations if it is a health insurance issuer that is otherwise described in section 162(m)(6)(C).

#### E. De Minimis Exception

##### 1. In General

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

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

other members of its aggregated group for that taxable year. For taxable years beginning after December 31, 2012, the notice provides that a person that would otherwise be a covered health insurance provider under section 162(m)(6)(C)(i)(II) for a taxable year is not treated as a covered health insurance provider for that taxable year if the premiums received by that person and all other members of its aggregated group from providing health insurance coverage that constitutes minimum essential coverage are less than two percent of the gross revenue of that person and all other members of its aggregated group for that taxable year.

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

The commenter also suggested that if an individual provides services for a member of an aggregated group, but does not provide any services to the

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

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

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

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

Commenters asked how the *de minimis* exception would apply in

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

## II. Premiums

### A. In General

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

### B. Amounts Received Under an Indemnity Reinsurance Contract

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

insurance provider, premiums received under an indemnity reinsurance contract are not treated as premiums from providing health insurance coverage.

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

### C. Direct Service Payments

A health insurance issuer or other person that receives premiums from providing health insurance coverage may enter into an arrangement with a third party to provide, manage, or arrange for the provision of services by physicians, hospitals, or other healthcare providers. In connection with this arrangement, the health insurance issuer or other person that receives premiums from providing health insurance coverage may pay compensation to the third party in the form of capitated, prepaid, periodic, or other payments, and the third party may bear some or all of the risk that the compensation is insufficient to pay the full cost of providing, managing, or arranging for the provision of services by physicians, hospitals, or other healthcare providers as required under the arrangement. In addition, the third party may be subject to healthcare provider, health insurance, licensing, financial solvency, or other regulation under state insurance law. Commenters suggested that compensation payments to these third parties under these types of arrangements should not be treated as premiums from providing health insurance coverage for purposes of section 162(m)(6) because, while the third party bears some risk in connection with providing, managing, or arranging for the provision of healthcare services, a health insurance issuer or other entity that receives premiums from providing health insurance coverage is ultimately responsible for providing health insurance coverage to the insureds. The commenters explained that these risk shifting arrangements are simply methods by which health insurance issuers and other entities that provide

health insurance coverage diversify and manage their risk, in a manner similar to reinsurance. The Treasury Department and the IRS agree with this comment. Accordingly, these proposed regulations provide that capitated, prepaid, periodic, or other payments (referred to as direct service payments) made by a health insurance issuer or other person that receives premiums from providing health insurance coverage to a third party as compensation for providing, managing, or arranging for the provision of healthcare services by physicians, hospitals, or other healthcare providers are not treated as premiums for purposes of section 162(m)(6), regardless of whether the third party is subject to healthcare provider, health insurance, licensing, financial solvency, or other similar regulatory requirements under state law.

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

## III. Disqualified Taxable Year

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

person is a covered health insurance provider.

#### IV. Applicable Individual

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

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

Commenters also suggested that future guidance clarify that the section 162(m)(6) deduction limitation applies to services provided by individuals that are natural persons and not services provided pursuant to a contract or

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

#### V. Applicable Individual Remuneration

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

covered health insurance provider in which the grant of the restricted stock is made.

#### VI. Deferred Deduction Remuneration

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

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

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

In response to a request for comments in Notice 2011–2, some commenters asked that taxpayers be permitted to use any reasonable method to attribute remuneration to taxable years of a covered health insurance provider, as long as the method is applied consistently. Commenters observed that the allocation methods for purposes of section 162(m)(5) set forth in Notice 2008–94 (relating to recipients of payments under the Troubled Asset Relief Program) may not be appropriate

for purposes of section 162(m)(6) because the methods in Notice 2008–94 were developed for employers expected to be subject to the deduction limitation under section 162(m)(5) only temporarily, and thus necessarily provided less flexibility than may be appropriate for purposes of section 162(m)(6). Permitting taxpayers to use any reasonable method to attribute remuneration to a taxable year of a covered health insurance provider, however, may lead to results that are inconsistent with section 162(m)(6) and the legislative intent underlying the statute. Accordingly, these proposed regulations provide rules for attributing applicable individual remuneration and deferred deduction remuneration to services performed by an applicable individual during a taxable year or years of a covered health insurance provider. Nonetheless, the Treasury Department and the IRS remain concerned about imposing undue burdens on taxpayers and request comments regarding the ease or difficulty of applying the attribution rules described in these proposed regulations and regarding specific alternatives for attributing applicable individual remuneration and deferred deduction remuneration to services performed during taxable years of a covered health insurance provider that would be less burdensome or otherwise more appropriate.

#### A. In General

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

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

performed by the applicable individual in the taxable year in which the latter of these two dates occurs.

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

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

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

#### B. Account Balance Plans

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

Under the standard attribution method, any increases or decreases in an account balance that occur in taxable years in which an applicable individual is not a service provider must be attributed to taxable years of the covered health insurance provider (i) during which the applicable individual is a service provider, and (ii) on one or more days of which the applicable individual retains an account balance under the plan. The Treasury Department and the IRS request comments on the appropriate method for attributing this remuneration to these taxable years. For taxable years beginning in 2013, and thereafter until the Treasury Department and the IRS issue further guidance prescribing the method for attributing this remuneration to these taxable years, this remuneration may be attributed

using any reasonable method to taxable years of the covered health insurance provider (i) during which the applicable individual is a service provider, and (ii) on one or more days of which the applicable individual retains an account balance under the plan. For this purpose, a method is reasonable only if it is consistent with a reasonable, good faith interpretation of section 162(m)(6) and is applied consistently for all remuneration provided by the covered health insurance provider under substantially similar plans or arrangements.

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

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

and how that change would apply if deductions for some portion of the deferred deduction remuneration have already been taken.

#### C. Nonaccount Balance Plans

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

Any increase (or decrease) in the present value of a future payment or payments under a nonaccount balance plan that occurs in a taxable year when an applicable individual is not a service provider must be attributed to taxable years of the covered health insurance provider during which the applicable individual (i) is a service provider and (ii) has a legally binding right to a future payment or payments under the nonaccount balance plan. The Treasury Department and IRS request comments on the appropriate method for attributing this remuneration to these taxable years. For taxable years beginning in 2013, and thereafter until the Treasury Department and the IRS issue further guidance prescribing the method for attributing this remuneration to these taxable years, this remuneration

may be attributed using any reasonable method to taxable years during which the applicable individual (i) is a service provider and (ii) has a legally binding right to the future payment or payments. For this purpose, a method is reasonable only if it is consistent with a reasonable, good faith interpretation of section 162(m)(6) and is applied consistently for all remuneration provided by the covered health insurance provider under substantially similar plans or arrangements.

#### D. Equity-Based Remuneration

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

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

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

#### E. Involuntary Separation Pay

These proposed regulations provide that involuntary separation pay is attributable to services performed by an applicable individual during the taxable year of the covered health insurance provider in which the involuntary

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

#### F. Substantial Risk of Forfeiture

An applicable individual's right to remuneration may be subject to a substantial risk of forfeiture. In response to Notice 2011-2, commenters suggested that remuneration be attributed to services performed over the period during which amounts are subject to a substantial risk of forfeiture (the vesting period). Consistent with this suggestion, these proposed regulations provide that in the case of remuneration that is subject to a substantial risk of forfeiture and that would otherwise be attributed to taxable years of a covered health insurance provider in accordance with (i) the general rule that attributes remuneration to the taxable year in which an applicable individual obtains a legally binding right to the remuneration, (ii) the attribution rules applicable to account balance plans, or (iii) the attribution rules applicable to nonaccount balance plans, the remuneration is attributed to taxable years of the covered health insurance provider using a two-step process. First, the remuneration is attributed to taxable years of the covered health insurance provider pursuant to the legally-binding-right rule or the rules applicable to account balance or nonaccount balance plans, as applicable. Second, the remuneration that was subject to a substantial risk of forfeiture is reattributed on a daily *pro rata* basis over the period that the remuneration was subject to a substantial risk of forfeiture (in other

words, reattributed evenly over the vesting period).

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

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

### VIII. Application of the \$500,000 Deduction Limitation

#### A. In General

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

#### B. Timing of Application of the Deduction Limitation

The \$500,000 deduction limitation with respect to the applicable

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

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

of the reduced deduction limitation and the amount of the deferred deduction remuneration that exceeds the deduction limitation cannot be deducted in any taxable year.

After the deduction limitation with respect to an applicable individual for a disqualified taxable year (the original disqualified taxable year) is applied to an amount of deferred deduction remuneration, the deduction limitation with respect to that applicable individual for the original disqualified taxable year is further reduced by the amount of the deferred deduction remuneration against which it is applied, but not below zero. If the applicable individual has an additional amount of deferred deduction remuneration attributable to services performed in the original disqualified taxable year that becomes otherwise deductible in a subsequent taxable year, the deduction limitation, as further reduced, is applied to that amount of deferred deduction remuneration in the taxable year in which it is otherwise deductible. This process continues for future taxable years in which deferred deduction remuneration attributable to services performed by the applicable individual in the original disqualified taxable year is otherwise deductible. No deduction is allowed for any applicable individual remuneration or deferred deduction remuneration to the extent that remuneration exceeds the deduction limitation in effect at the time it is applied to the remuneration.

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

Any payment of deferred deduction remuneration may include remuneration that is attributable to services performed by an applicable individual in one or more taxable years of a covered health insurance provider under the rules set out in these proposed regulations. For example, remuneration resulting from the vesting of restricted stock that is subject to a substantial risk of forfeiture for three full taxable years of a covered health insurance provider is attributable to services performed in each of the three years during which the restricted stock was subject to a substantial risk of forfeiture. In that case, a separate deduction limitation applies to each portion of the payment that is attributed to services performed in a different disqualified taxable year of the covered health insurance provider. Any portion of the payment that is attributed to a disqualified taxable year will be deductible only to the extent that it does not exceed the deduction limit that

applies to the applicable individual for that disqualified taxable year, as that deduction limit may have been previously reduced by the amount of any applicable individual remuneration or deferred deduction remuneration attributable to services performed in that disqualified taxable year that was previously deductible. If payments of deferred deduction remuneration under an account balance plan or a nonaccount balance plan are paid in installments (rather than a single lump-sum), the payments are deemed to be made from the deferred deduction remuneration to which they are attributable under the applicable attribution rules, with payments deemed to be made first with respect to the earliest taxable years to which they could be attributed. The proposed regulations contain numerous examples to illustrate how these rules apply to services performed and compensation payments made over multiple taxable years.

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

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

In the case of two or more members of an aggregated group that are otherwise entitled to deduct in any taxable year applicable individual remuneration or deferred deduction remuneration attributable to services performed by an applicable individual in a disqualified taxable year that exceeds the applicable deduction limitation for that disqualified taxable year, the deduction limitation is prorated and allocated to the members of the aggregated group in proportion to

the applicable individual remuneration or deferred deduction remuneration that each otherwise would be entitled to deduct in the taxable year (but for section 162(m)(6)).

### **IX. Corporate Transactions**

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

However, these proposed regulations provide that in certain circumstances the deduction limitation under section 162(m)(6) may apply to a person that is not treated as a covered health

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

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

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

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

Commenters suggested that deferred deduction remuneration earned or granted in taxable years beginning before January 1, 2010, be attributed to services performed before that time, regardless of whether the remuneration

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

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

#### **XI. Transition Rules for Certain Deferred Deduction Remuneration**

Section 162(m)(6) applies to deferred deduction remuneration attributable to services performed in a disqualified taxable year beginning after December 31, 2009 that is otherwise deductible in a taxable year beginning after December

31, 2012. As described in section I.B of this preamble, for taxable years beginning before January 1, 2013, a covered health insurance provider is any health insurance issuer (as defined in section 9832(b)(2)) that receives premiums from providing health insurance coverage (as defined in section 9832(b)(1)) (a pre-2013 covered health insurance provider). For taxable years beginning after December 31, 2012, a covered health insurance provider is any health insurance issuer (as defined in section 9832(b)(2)) that receives at least 25 percent of its gross premiums from providing minimum essential coverage (as defined in section 5000A(f)) (a post-2012 covered health insurance provider). Thus, the definition of the term *covered health insurance provider* is narrower for taxable years beginning after December 31, 2012, than it is for taxable years beginning before January 1, 2013.

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

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

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

#### Effect on Other Documents

These proposed regulations do not affect the applicability of Notice 2011–2, (2011–1 CB 260). However, upon the effective date of the final regulations, the Treasury Department and the IRS anticipate that Notice 2011–2 will become obsolete for periods after the effective date of the final regulations.

#### Proposed Effective Date

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

taxable years to which the regulations will apply.

#### Special Analyses

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

#### Comments and Requests for Public Hearing

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

#### Drafting Information

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

#### List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

#### Proposed Amendments to the Regulations

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

#### PART 1—INCOME TAXES

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

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

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

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

(a) *Scope.* This § 1.162–31 provides rules regarding the deduction limitation under section 162(m)(6), which provides that a covered health insurance provider's deduction for applicable individual remuneration and deferred deduction remuneration attributable to services performed by an applicable individual in a disqualified taxable year is limited to \$500,000. Paragraph (b) of this section provides definitions of the terms used in this section. Paragraph (c) of this section states the general limitation on deductions under section 162(m)(6). Paragraph (d) of this section provides rules on the attribution of applicable individual remuneration and deferred deduction remuneration to services provided in one or more taxable years of a covered health insurance provider. Paragraph (e) of this section provides rules on the application of the deduction limitation to applicable individual remuneration and deferred deduction remuneration that is otherwise deductible under chapter 1 of the Internal Revenue Code (Code) but for the deduction limitation under section 162(m)(6) (referred to in these regulations as remuneration that is otherwise deductible). Paragraph (f) of this section provides rules for persons participating in certain corporate transactions. Paragraph (g) of this section provides rules on the coordination of section 162(m)(6) with sections 162(m)(1) and 280G. Paragraph (h) of this section provides rules for determining the amount of remuneration that is not subject to the deduction limitation under section 162(m)(6) due to application of the statutory effective date (referred to in these regulations as grandfathered amounts). Paragraph (i) of this section provides transition rules for deferred deduction remuneration that is attributable to services performed in taxable years beginning after December 31, 2009 and before January 1, 2013. Paragraph (j) of this section provides the effective and applicability dates of the rules in this section.

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

(2) *Aggregated group.* For purposes of this section, an *aggregated group* is a health insurance issuer and each other person that is treated as a single employer with the health insurance

issuer at any time during the taxable year of the health insurance issuer under sections 414(b) (controlled groups of corporations), 414(c) (partnerships, proprietorships, etc. under common control), 414(m) (affiliated service groups), or 414(o), except that the rules in section 1563(a)(2) and (a)(3) (with respect to corporations) and the rules in § 1.414(c)-2(c) (with respect to trades or businesses under common control) for brother-sister groups and combined groups are disregarded.

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

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

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

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

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

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

coverage (as defined in section 9832(b)(1)),

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

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

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

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

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

taxable year that the health insurance issuer and the other members of its aggregated group would otherwise be treated as covered health insurance providers under paragraph (b)(4)(i) of this section. A health insurance issuer and any member of its aggregated group that would otherwise be a covered health insurance provider under paragraph (b)(4)(i) of this section for a taxable year beginning after December 31, 2012 is not treated as a covered health insurance provider 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 for providing health insurance coverage (as defined in section 9832(b)(1)) that constitutes minimum essential coverage (as defined in section 5000A(f)) are less than two percent of the gross revenues of the health insurance issuer and all other members of its aggregated group for the taxable year that the health insurance issuer and the other members of its aggregated group would otherwise be treated as covered health insurance providers under paragraph (b)(4)(i) of this section. In determining whether premiums constitute less than two percent of gross revenues, the amount of premiums and gross revenues must be determined in accordance with generally accepted accounting principles.

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

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

*Example 1.* (i) Corporations Y and Z are members of an aggregated group under paragraph (b)(2) of this section. Y is a health insurance issuer that is a covered health insurance provider pursuant to paragraph (b)(4)(i)(B) of this section and receives premiums from providing health insurance coverage that is minimum essential coverage during its 2015 taxable year in an amount that is less than two percent of the combined gross revenues of Y and Z for their 2015

taxable years. Z is not a health insurance issuer.

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

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

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

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

(ii) Although the premiums received by the members of the aggregated group from providing minimum essential coverage are more than two percent of the gross revenues of the aggregated group for the taxable years during which the members would otherwise

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

(9) *Remuneration*—(i) *In general.* For purposes of this section, except as provided in paragraph (b)(9)(ii) of this section, the term *remuneration* has the

same meaning as applicable employee remuneration, as defined in section 162(m)(4), but without regard to the exceptions under section 162(m)(4)(B) (remuneration payable on a commission basis), section 162(m)(4)(C) (performance-based compensation), and section 162(m)(4)(D) (existing binding contracts), and the regulations under those sections.

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

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

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

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

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

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

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

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

under section 83(b) is applicable individual remuneration for the disqualified taxable year of the covered health insurance provider in which the grant of the restricted stock is made. See paragraphs (d)(1)(iv) and (d)(5)(v) of this section for certain remuneration that is not treated as applicable individual remuneration for purposes of this section.

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

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

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

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

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

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

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

(d) *Services to which remuneration is attributable—(1) Attribution to a taxable year—(i) In general.* The deduction limitation under section 162(m)(6) applies to applicable individual remuneration and deferred deduction remuneration attributable to services performed by an applicable individual in a disqualified taxable year of a covered health insurance provider. When an amount of applicable individual remuneration or deferred deduction remuneration becomes otherwise deductible (and not before that time), that remuneration must be attributed to services performed by an applicable individual in a taxable year of the covered health insurance provider

in accordance with the rules of this paragraph (d). After the remuneration has been attributed to services performed by an applicable individual in a taxable year of a covered health insurance provider, the rules of paragraph (e) of this section are then applied to determine whether the deduction with respect to the remuneration is limited by section 162(m)(6).

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

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

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

(ii) Because the nonqualified deferred compensation plan is an account balance plan, deferred deduction remuneration provided under the plan is attributable to services provided by A in accordance with paragraph (d)(3)(i) of this section. Z does not use the alternate method of allocating earnings and losses permitted under paragraph (d)(3)(ii) of this section. Accordingly, the deferred deduction remuneration under the plan attributable to services provided by A in a taxable year is generally equal to the increase in the account

balance on the last day of each taxable year over the account balance on the last day of the immediately preceding taxable year, increased by the amount of any payments made during the taxable year. The increases in A's account balances are \$10,000 for 2014, \$3,000 for 2015, \$4,000 for 2016, and \$7,000 for 2017. Therefore, pursuant to paragraph (d)(1)(ii), Z must attribute \$10,000 of the \$15,000 payment to services performed by A in 2014, \$3,000 of the \$15,000 payment to services performed by A in 2015, and \$2,000 of the \$15,000 payment to services performed by A in 2016 (leaving \$2,000 remaining to be attributed to 2016). Similarly, Z must attribute \$2,000 of the \$9,000 payment to services performed by A in 2016, and the remaining \$7,000 of the \$9,000 payment to services performed by A in 2017.

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

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

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

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

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

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

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

objective provision creating a substantial risk of forfeiture.

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

(B) *Attribution of increases (or decreases) in an account balance in taxable years during which an*

*applicable individual is not a service provider.* [Reserved].

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

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

(B) *Attribution of earnings or losses.* Earnings or losses on a principal addition (including earnings and losses arising after an applicable individual ceases to be a service provider) are attributable to the services provided by the applicable individual in the same disqualified taxable year of the covered health insurance provider to which the principal addition is attributed in accordance with paragraph (d)(3)(ii)(A) of this section. Earnings are treated as remuneration for the taxable year to which they are attributed, and losses are treated as reductions to deferred deduction remuneration for that taxable year and may offset other deferred deduction remuneration (but not applicable individual remuneration) attributable to services performed by the applicable individual during that taxable year (or if there is not sufficient deferred deduction remuneration to offset the reduction entirely during that taxable year, the first subsequent taxable year or years in which the applicable individual has deferred deduction remuneration to be offset by the loss, if applicable).

(C) *Earnings.* Whether remuneration constitutes earnings on a principal addition is determined under the principles defining income attributable to an amount taken into account under § 31.3121(v)(2)-1(d)(2). Therefore, for an account balance plan (as defined in § 31.3121(v)(2)-1(c)(1)(ii)(A)), earnings on an amount deferred generally include an amount credited on behalf of the applicable individual under the terms of the arrangement that reflects a rate of return that does not exceed either the rate of return on a predetermined actual investment (as defined in § 31.3121(v)(2)-1(d)(2)(i)(B)), or, if the income does not reflect the rate of

return on a predetermined actual investment, a reasonable rate of interest. For purposes of this section, the use of an unreasonable rate of return generally will result in the treatment of some or all of the remuneration as a principal addition that is attributable to services provided by an applicable individual in a taxable year of a covered health insurance provider in accordance with paragraph (d)(3)(ii)(A) of this section. For purposes of determining whether an account balance plan has a reasonable rate of return, the rules of § 31.3121(v)(2)-1(d)(2)(iii)(A) apply.

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

(4) *Nonaccount balance plans*—(i) *In general.* The increase (or decrease) in the present value of the future payment or payments to which an applicable individual has a legally binding right under a plan described in § 1.409A-1(c)(2)(i)(C) (nonaccount balance plan) as of a measurement date (as defined in paragraph (d)(3)(i)), over (or under) the present value of the future payment or payments as of the last day of the immediately preceding taxable year is attributable to services provided by the applicable individual in the taxable year of the covered health insurance provider that includes the measurement date. For purposes of determining the increase (or decrease) in the present value of a future payment or payments under a nonaccount balance plan, the rules of § 31.3121(v)(2)-1(c)(2) apply (including the requirement that reasonable actuarial assumptions and methods be used). For purposes of determining the increase (or decrease) in the present value of a future payment or payments under a nonaccount balance plan attributable to any taxable year, the present value of the future payment or payments as of the last day of the taxable year is increased by the amount of any payments made during that taxable year. Increases in the present value of the future payment or payments to which an applicable individual has a legally binding right under a nonaccount balance plan with respect to any taxable year are treated as remuneration attributable to services

performed in that taxable year. Decreases in the present value of the future payment or payments to which an applicable individual has a legally binding right under a nonaccount balance plan with respect to any taxable year are treated as reductions to deferred deduction remuneration for that taxable year and may offset other deferred deduction remuneration (but not applicable individual remuneration) attributable to services performed by the applicable individual during that taxable year under any plan or arrangement (or if there is not sufficient deferred deduction remuneration for that taxable year to offset the reduction entirely, the excess may offset deferred deduction remuneration in the first subsequent taxable year or years in which the applicable individual has deferred deduction remuneration to be offset by the loss).

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

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

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

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

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

(or becomes transferable as defined in § 1.83-3(d)).

(iii) *Restricted stock units.*

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

(iv) *Partnership interests and other equity.* The rules provided in this paragraph (d)(5) may be applied by analogy to grants of equity-based compensation in situations in which the compensation is determined by reference to equity in an entity treated as a partnership for federal tax purposes, or where compensation is determined by reference to equity interests in an entity described in § 1.409A-1(b)(5)(iii) (for example, a mutual company).

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

(7) *Reimbursements.* Remuneration that is provided in the form of a reimbursement or benefit provided in-kind (other than cash) is attributable to services performed by an applicable individual in the taxable year of the covered health insurance provider in which the applicable individual makes

a payment for which the applicable individual has a right to reimbursement or receives the in-kind benefit, except that remuneration provided in the form of a reimbursement or in-kind benefit during a taxable year of the covered health insurance provider in which an applicable individual is not a service provider is attributable to services provided in the first preceding taxable year of the covered health insurance provider in which the applicable individual is a service provider.

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

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

*Example 1 (Account balance plan with earnings using the standard attribution method).* (i) B is an applicable individual of corporation Y for all relevant taxable years. On January 1, 2016, B begins participating in a nonqualified deferred compensation plan of Y that is an account balance plan. Under the terms of the plan, all amounts are fully vested at all times, and Y will pay B's entire account balance on January 1, 2019. Y credits \$10,000 to B under the plan annually on January 1 for three years beginning on January 1, 2016. The account earns interest at a fixed rate of five percent per year, compounded annually under the terms of the

plan, which solely for purposes of this example, is assumed to be a reasonable rate of interest. Thus, B's account balance is \$10,500 ( $\$10,000 + (\$10,000 \times 5\%)$ ) on December 31, 2016; \$21,525 ( $\$10,500 + \$10,000 + (\$20,500 \times 5\%)$ ) on December 31, 2017; and \$33,101 ( $\$21,525 + \$10,000 + (\$31,525 \times 5\%)$ ) on December 31, 2018. Y attributes increases and decreases in account balances under the plan using the standard allocation method described in paragraph (d)(3)(i) of this section.

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

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

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

*Example 3 (Account balance plan with earnings and losses using the standard attribution method).* (i) The facts are the same as in *Example 1*, except that the earnings under the terms of the plan are based on a notional investment in a predetermined actual investment (as defined in § 31.3121(v)(2)–1(e)(2)(i)(B)), which results in B's account balance increasing by five

percent in the 2016 taxable year, decreasing by five percent in the 2017 taxable year, and increasing again by five percent in the 2018 taxable year. Therefore, on December 31, 2016, B's account balance is \$10,500 ( $\$10,000 + (\$10,000 \times 5\%)$ ); on December 31, 2017, B's account balance is \$19,475 ( $\$10,500 + \$10,000 - (\$20,500 \times 5\%)$ ); and on December 31, 2018, B's account balance is \$30,479 ( $\$19,475 + \$10,000 + (\$29,475 \times 5\%)$ ).

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

(iii) Accordingly, \$10,500 of deferred deduction remuneration is attributable to services performed by B in Y's 2016 taxable year (the difference between the \$10,500 account balance on December 31, 2016 and the zero account balance on December 31, 2015); \$8,975 of deferred deduction remuneration is attributable to services performed in Y's 2017 taxable year (the difference between the \$19,475 account balance on December 31, 2017 and the \$10,500 account balance on December 31, 2016); and \$11,474 of deferred deduction remuneration is attributable to services performed in Y's 2018 taxable year (the difference between the \$30,479 account balance on December 31, 2018 and the \$19,475 account balance on December 31, 2017).

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

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

applying the section 162(m)(6) deduction limitation. With respect to the \$10,000 principal addition to B's account in 2018, the account balance is \$10,500 on December 31, 2018. Therefore, the \$500 of earnings is attributable to Y's 2018 taxable year.

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

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

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

(ii) Under the attribution method for nonaccount balance plans described in paragraph (d)(4) of this section, the increase (or decrease) in the present value of the future payment to which D is entitled under the nonaccount balance plan as of the last day of W's taxable year, over (or under) the

present value of the future payment as of the last day of the preceding taxable year, increased by any payments made during the taxable year, is attributable to services provided by D in that taxable year. W determines the present value of this payment using an interest rate of five percent for all years, which solely for purposes of this example, is assumed to be a reasonable actuarial assumption. As of December 31, 2021, D has the right to a payment of \$240,000 on January 1, 2024 ( $\$400,000 \times 10\% \times 6$  years of service). The present value as of December 31, 2021 of \$240,000 payable on January 1, 2024 is \$217,687. Therefore, \$217,687 of deferred deduction remuneration is attributable to services performed by D in W's 2021 taxable year.

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

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

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

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

**Example 8 (Restricted stock).** (i) F is an applicable individual of corporation U for all relevant taxable years. On January 1, 2017, U grants F 100 shares of restricted U common

stock. Under the terms of the grant, the shares will be forfeited if F voluntarily terminates employment before December 31, 2019 (so that the shares are subject to a substantial risk of forfeiture through that date) and are nontransferable until the substantial risk of forfeiture lapses. F does not make an election under section 83(b) and continues in employment with U through December 31, 2019, at which time F's rights in the stock become substantially vested within the meaning of § 1.83-3(b) and the fair market value of a share of the stock is \$109.50. The deferred deduction remuneration resulting from the vesting of the restricted stock is \$10,950 ( $\$109.50 \times 100$ ).

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

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

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

**Example 10 (Involuntary separation pay).** (i) H is an applicable individual of corporation S. On January 1, 2015, H and S enter into an employment contract providing

that S will make two payments of \$150,000 each to H if H has an involuntary separation from service. Under the terms of the contract, the first payment is due on January 1 following the involuntary separation from service, and the second payment is due on January 1 of the following year. On December 31, 2016, H has an involuntary separation from service. S pays H \$150,000 on January 1, 2017 and \$150,000 on January 1, 2018.

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

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

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

(10) **Certain deferred deduction remuneration subject to a substantial risk of forfeiture.** If remuneration is attributable in accordance with paragraph (d)(2) (legally binding right), (d)(3) (account balance plan), or (d)(4) (nonaccount balance plan) of this section to services performed in a period that includes two or more taxable years of a covered health insurance provider during which the remuneration is subject to a substantial risk of forfeiture, that remuneration must be attributed using a two-step process. First, the remuneration must be attributed to the taxable years of the covered health insurance provider in accordance with paragraph (d)(2), (3), or (4) of this section, as

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

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

*Example 1 (Account balance plan subject to a substantial risk of forfeiture using the standard attribution method).* (i) J is an applicable individual of corporation Q for all relevant taxable years. On January 1, 2016, J begins participating in a nonqualified deferred compensation plan that is an account balance plan. Under the terms of the plan, Q will pay J's account balance on January 1, 2021, but only if J continues to provide substantial services to Q through December 31, 2018 (so that the amount credited to J's account is subject to a substantial risk of forfeiture through that date). Q credits \$10,000 to J's account annually for five years on January 1 of each year beginning on January 1, 2016. The account earns interest at a fixed rate of five percent per year, compounded annually, which solely for the purposes of this example, is assumed to be a reasonable rate of interest. Therefore, J's account balance is

\$10,500 (\$10,000 + (\$10,000 × 5%)) on December 31, 2016; \$21,525 (\$10,500 + \$10,000 + (\$20,500 × 5%)) on December 31, 2017; \$33,101 (\$21,525 + \$10,000 + (\$31,525 × 5%)) on December 31, 2018; \$45,256 (\$33,101 + \$10,000 + (\$43,101 × 5%)) on December 31, 2019; and \$58,019 (\$45,256 + \$10,000 + (\$55,256 × 5%)) on December 31, 2020. Q attributes increases and decreases in account balances under the plan using the standard attribution method described in paragraph (d)(3)(i) of this section.

(ii) Under the standard attribution method for account balance plans described in paragraph (d)(3)(i) of this section, any increases in J's account balance as of the last day of Q's taxable year over the account balance as of the last day of the immediately preceding taxable year, increased by any payments made during the taxable year, is attributable to services provided by J in that taxable year. Accordingly, \$10,500 of deferred deduction remuneration is initially attributable to services performed by J in Q's 2016 taxable year (the difference between the \$10,500 account balance on December 31, 2016 and the zero account balance on December 31, 2015); \$11,025 of deferred deduction remuneration is initially attributable to services performed by J in Q's 2017 taxable year (the difference between the \$21,525 account balance on December 31, 2017 and the \$10,500 account balance on December 31, 2016); \$11,576 of deferred deduction remuneration is initially attributable to services performed by J in Q's 2018 taxable year (the difference between the \$33,101 account balance on December 31, 2018 and the \$21,525 account balance on December 31, 2017); \$12,155 of deferred deduction remuneration is attributable to services performed by J in Q's 2019 taxable year (the difference between the \$45,256 account balance on December 31, 2019 and the \$33,101 account balance on December 31, 2018); and \$12,763 of deferred deduction remuneration is attributable to services performed by J in Q's 2020 taxable year (the difference between the \$58,019 account balance on December 31, 2020 and the \$45,256 account balance on December 31, 2019).

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

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

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

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

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

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

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

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

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

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

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

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

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

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

(xi) As of December 31, 2025, K has a right to a \$500,000 payment on January 1, 2026 ( $\$500,000 \times 10\% \times 10$  years of service). The present value as of December 31, 2025, of a

\$500,000 payment to be made on January 1, 2026 is \$500,000. Therefore, the applicable individual remuneration attributable to services performed by K in J's 2025 taxable year is \$92,857 ( $\$500,000 - \$407,143$ ).

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

(e) *Application of the deduction limitation—(1) To aggregate amounts.* The \$500,000 deduction limitation is applied to the aggregate amount of applicable individual remuneration and deferred deduction remuneration attributable to services performed by an applicable individual in a disqualified taxable year. The aggregate amount of applicable individual remuneration and deferred deduction remuneration attributable to services performed by an applicable individual in a disqualified taxable year that exceeds the \$500,000 deduction limitation is not allowed as a deduction in any taxable year. Therefore, for example, if an applicable individual has \$500,000 or more of applicable individual remuneration attributable to services provided to a disqualified taxable year, the amount of that applicable individual remuneration that exceeds \$500,000 is not deductible in any taxable year, and no deferred deduction remuneration attributable to services performed by the applicable individual in that disqualified taxable year is deductible in any taxable year. However, if an applicable individual has applicable individual remuneration for a disqualified taxable year that is less than \$500,000 and deferred deduction remuneration attributable to services performed in the same disqualified taxable year that, when combined with the applicable individual remuneration for the year, is greater than \$500,000, all of the applicable individual remuneration is deductible in that disqualified taxable year, but the amount of deferred deduction remuneration that is deductible in future taxable years is limited to the excess of \$500,000 over

the amount of the applicable individual remuneration for that year.

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

the deduction limitation is applied to the remuneration.

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

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

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

*Example 1 (Lump-sum payment of deferred deduction remuneration attributable to a single taxable year).*

(i) L is an applicable individual of corporation O. During O's 2015 taxable year, O pays L \$550,000 in salary, which is applicable individual remuneration, and grants L a right to \$50,000 of deferred deduction remuneration payable upon L's separation from

service from O. L has a separation from service in 2020, at which time O pays L the \$50,000 of deferred deduction remuneration attributable to services performed by L in O's 2015 taxable year.

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

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

(ii) The \$500,000 deduction limitation for 2016 is applied first to M's \$300,000 of applicable individual remuneration for 2016. Because the deduction limitation is greater than the applicable individual remuneration, N may deduct the entire \$300,000 of applicable individual remuneration paid in 2016. The \$500,000 deduction limitation is then reduced to \$200,000 by the amount of the applicable individual remuneration (\$500,000 – \$300,000). The reduced deduction limitation is applied to M's \$120,000 of deferred deduction remuneration attributable to services performed by M in N's 2016 taxable year that is paid in 2020. Because the reduced deduction

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

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

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

(iii) Under the rules in paragraphs (d)(1)(ii) and (e)(2)(ii)(B) of this section, the January 1, 2016 payment of \$200,000 is deemed a payment of remuneration attributed to services performed by N in the earliest year that the amount could be attributed under

paragraph (d)(3)(i) of this section. M's first taxable year to which any portion of the payment could be attributed is M's 2013 taxable year. Accordingly, \$50,000 of the \$200,000 payment is attributed to services performed by N in M's 2013 taxable year. M's next earliest taxable year to which any portion of the payment could be attributed is M's 2014 taxable year. Accordingly, \$50,000 of the \$200,000 payment is attributed to services performed by N in M's 2014 taxable year. M's next earliest disqualified taxable year to which any portion of the payment could be attributed is M's 2015 taxable year. Accordingly, the remaining \$100,000 of the \$200,000 payment is attributed to services performed by N in M's 2015 taxable year.

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

*Example 4 (Installment payments attributable to multiple taxable years from an account balance plan using the standard attribution method).* (i) O is an applicable individual of corporation L for all relevant taxable years. On January 1, 2016, O begins participating in a nonqualified deferred

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

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

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

deduction remuneration (\$50,000) is treated as paid in a subsequent taxable year.

(iv) The portion of the deferred deduction remuneration attributed to services performed in a disqualified taxable year under paragraph (d) of this section that exceeds the deduction limitation for that disqualified taxable year, as reduced, is not deductible for any taxable year. For L's 2016 taxable year, the deduction limitation is reduced to zero by the \$500,000 of applicable individual remuneration for that year. Because \$100,000 exceeds the reduced deduction limitation of zero, the \$100,000 of the deferred deduction remuneration is not deductible for L's 2019 taxable year, the year of payment, or any other taxable year. For L's 2017 taxable year, the deduction limitation is reduced to \$200,000 by the \$300,000 of applicable individual remuneration for that year. Because \$150,000 does not exceed that reduced deduction limitation, the \$150,000 of the deferred deduction remuneration is deductible for 2019, the year of payment. The deduction limitation for remuneration attributable to services performed by O in 2017 is then reduced to \$50,000, and this reduced limitation is applied to any future payment of deferred deduction remuneration attributable to services performed by O in 2017. For L's 2018 taxable year, the deduction limitation is reduced to \$50,000 by the \$450,000 of applicable individual remuneration for that year. Because the \$150,000 of deferred deduction remuneration exceeds the reduced deduction limitation of \$50,000, \$100,000 of the \$150,000 attributable to services performed by O in L's 2018 taxable year is not deductible for L's 2019 taxable year, the year of payment, or any other taxable year. As a result, \$200,000 of the \$400,000 payment (\$0 + \$150,000 + \$50,000) is deductible by L for L's 2019 taxable year, and the remaining \$200,000 is not deductible by L for any taxable year.

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

(vi) The portion of the deferred deduction remuneration attributed to a disqualified taxable year under paragraph (d) of this section that exceeds the deduction limitation

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

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

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

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

\$100,000 of the \$400,000 payment is attributed to services performed by O in L's 2018 taxable year. Because the portion of the \$400,000 payment attributed to L's 2018 taxable year is less than the total deferred deduction remuneration attributable to services performed by O in L's 2018 taxable year, the excess deferred deduction remuneration (\$50,000) is treated as paid in a subsequent taxable year.

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

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

\$200,000 payment is attributed to services performed by O in L's 2019 taxable year.

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

*(4) Application of deduction limitation to aggregated groups of covered health insurance providers—(i) In general.* The total combined deduction for applicable individual remuneration and deferred deduction remuneration attributable to services performed by an applicable individual in a disqualified taxable year allowed for all members of an aggregated group that are treated as covered health insurance providers for any taxable year is limited to \$500,000. Therefore, if two or more members of an aggregated group that are treated as covered health insurance providers may otherwise deduct applicable individual remuneration or deferred deduction remuneration attributable to services provided by an applicable individual in a disqualified taxable year, the applicable individual remuneration and deferred deduction remuneration otherwise deductible by all members of the aggregated group is combined, and the deduction limitation is applied to the total amount.

*(ii) Proration of deduction limitation.* If the total amount of applicable individual remuneration or deferred deduction remuneration attributable to services performed by an applicable individual in a disqualified taxable year that is otherwise deductible by two or more members of an aggregated group in any taxable year exceeds the \$500,000 deduction limitation (as reduced by previous applications to applicable individual remuneration or deferred deduction remuneration, if applicable), the deduction limitation is prorated based on the applicable individual remuneration and deferred deduction remuneration otherwise deductible by

the members of the aggregated group in the taxable year and allocated to each member of the aggregated group. The deduction limitation allocated to each member of the aggregated group is determined by multiplying the deduction limitation for the disqualified taxable year (as previously reduced, if applicable) by a ratio, the numerator of which is the applicable individual remuneration and deferred deduction remuneration otherwise deductible by that member in that taxable year that is attributable to services performed by the applicable individual in the disqualified taxable year, and the denominator of which is the total applicable individual remuneration and deferred deduction remuneration otherwise deductible by all members of the aggregated group in that taxable year that is attributable to services performed by the applicable individual in the disqualified taxable year. The amount of applicable individual remuneration or deferred deduction remuneration otherwise deductible by a member of the aggregated group in excess of the portion of the deduction limitation allocated to that member is not deductible in any taxable year.

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

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

(ii) Because I, J, and K are members of the same aggregated group, the applicable individual remuneration otherwise deductible by them is aggregated for purposes of applying the deduction limitation. Further, because the aggregate applicable individual remuneration otherwise deductible by I, J, and K for 2016 exceeds the deduction limitation for C for that taxable year, the deduction limitation is prorated and allocated to the members of the aggregated group in proportion to the applicable individual remuneration otherwise deductible by each member of the aggregated group for that taxable year. Therefore, the deduction limitation that applies to the applicable individual remuneration otherwise deductible by K is

\$250,000 ( $\$500,000 \times (\$750,000 / \$1,500,000)$ ); the deduction limitation that applies to the applicable individual remuneration otherwise deductible by J is \$150,000 ( $\$500,000 \times (\$450,000 / \$1,500,000)$ ); and the deduction limitation that applies to applicable individual remuneration otherwise deductible by I is \$100,000 ( $\$500,000 \times (\$300,000 / \$1,500,000)$ ). Therefore, for the 2016 taxable year, K may not deduct \$500,000 of the \$750,000 of applicable individual remuneration paid to C ( $\$750,000 - \$250,000$ ); J may not deduct \$300,000 of the \$450,000 of applicable individual remuneration paid to C ( $\$450,000 - \$150,000$ ); and I may not deduct \$200,000 of the \$300,000 of applicable individual remuneration paid to C ( $\$300,000 - \$100,000$ ).

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

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

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

(ii) The results are the same as *Example 2*, except that the reduced deduction limitation of \$100,000 is prorated between K and J in

proportion to the deferred deduction remuneration otherwise deductible by them for 2018. Accordingly, \$44,444 of the remaining deduction limitation is allocated to K ( $\$100,000 \times (\$60,000 / \$135,000)$ ), and \$55,556 of the remaining deduction limitation is allocated to J ( $\$100,000 \times (\$75,000 / \$135,000)$ ). Because the \$60,000 of deferred deduction remuneration otherwise deductible by K exceeds the \$44,444 deduction limitation applied to that remuneration, K may deduct only \$44,444 of the \$60,000 payment, and \$15,556 may not be deducted by K for any taxable year. Similarly, because the \$75,000 of deferred deduction remuneration otherwise deductible by J exceeds the \$55,556 deduction limitation applied to that remuneration, J may deduct only \$55,556 of the \$75,000 payment, and \$19,444 may not be deducted by J for that taxable year or any other taxable year.

(f) *Corporate transactions—(1) Treatment as a covered health insurance provider in connection with a corporate transaction—(i) In general.* Except as otherwise provided in this paragraph (f), a person that participates in a corporate transaction is a covered health insurance provider for the taxable year in which the corporate transaction occurs and any subsequent taxable year if it would otherwise be a covered health insurance provider under paragraph (b)(4) of this section for that taxable year. For example, if a member of an aggregated group purchases a health insurance issuer that is a covered health insurance provider (so that the health insurance issuer becomes a member of the aggregated group), each member of the acquiring aggregated group generally will be a covered health insurance provider for the taxable year in which the corporate transaction occurs and each subsequent taxable year in which the health insurance issuer continues to be a member of the group, unless the *de minimis* exception applies. For purposes of this paragraph (f), the term *corporate transaction* means a merger, acquisition of assets or stock, disposition, reorganization, consolidation, or separation, or any other transaction (including a purchase or sale of stock or other equity interest) resulting in a change in the composition of an aggregated group.

(ii) *Transition period relief for persons becoming covered health insurance providers solely as a result of a corporate transaction—(A) In general.* Except as provided in paragraph (f)(1)(ii)(B) of this section, a person that is not a covered health insurance provider before a corporate transaction, but would (except for application of this paragraph (f)(1)(ii)(A)) become a covered health insurance provider solely as a

result of the corporate transaction, is not treated as a covered health insurance provider subject to the deduction limitation of section 162(m)(6) in the taxable year of that person in which the corporate transaction occurs (the transition period).

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

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

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

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

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

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

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

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

*Example 2.* (i) On January 1, 2016, corporations D, E, and F are members of a controlled group within the meaning of section 414(b). F is a health insurance issuer that is a covered health insurance provider under paragraph (b)(4)(i)(B) of this section. D and E are not health insurance issuers (but are treated as covered health insurance providers pursuant to paragraph (b)(4)(i)(C) and (D) of this section). F's taxable year is a fiscal year ending on September 30. P is an applicable individual of F for all taxable years. On May 1, 2016, a controlled group within the meaning of section 414(b) consisting of corporations C and B purchases all of the stock of corporation F, resulting in a controlled group within the meaning of section 414(b) consisting of corporations C, B, and F. C and B are not health insurance issuers. The C, B, and F controlled group is a consolidated group within the meaning of § 1.1502-1(h). Thus, F's taxable year ends on May 1, 2016 by reason of § 1.1502-76(b)(1)(ii)(A)(1), and F becomes part of the C, B, and F consolidated group for the taxable year ending December 31, 2016.

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

(iii) P is an applicable individual whose remuneration is subject to the deduction limitation under section 162(m)(6) for F's short taxable year ending May 1, 2016. In addition, remuneration for services by P for C, B or F after May 1, 2016, during the taxable year of the consolidated group ending December 31, 2016, is subject to the deduction limitation under section 162(m)(6), even though C and B are not

treated as covered health insurance providers for their taxable year ending December 31, 2016 by reason of the transition period relief of paragraph (d)(1)(ii)(A) of this section.

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

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

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

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

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

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

*Example.* Corporation A, a covered health insurance provider, pays \$750,000 of applicable individual remuneration to P, an applicable individual, during A's

disqualified taxable year ending December 31, 2016. Of the \$750,000, \$300,000 is an excess parachute payment as defined in section 280G(b)(1), the deduction for which is disallowed by reason of that section. The excess parachute payment reduces the \$500,000 deduction limitation to \$200,000 (\$500,000—\$300,000). Therefore, A may deduct only \$200,000 of the \$750,000 in applicable individual remuneration, and \$250,000 of the payment is not deductible by reason of section 162(m)(6).

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

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

(ii) *Nonaccount balance plans.* The amount of remuneration attributable to services performed in taxable years beginning before January 1, 2010 under a nonqualified deferred compensation plan that is a nonaccount balance plan (as defined in § 1.409A-1(c)(2)(i)(C)), equals the present value of the remuneration to which the applicable individual would have been entitled under the plan if the applicable individual voluntarily terminated services without cause on the last day of the first taxable year of the covered health insurance provider beginning before January 1, 2010 and received a payment of the benefit available from the plan on the earliest possible date allowed under the plan to receive a payment of benefits following the termination of service, and received the benefit in the form with the maximum value. Notwithstanding the foregoing, for any subsequent taxable year of the covered health insurance provider, this amount may increase to equal the present value of the benefit the

applicable individual actually becomes entitled to receive, in the form and at the time actually paid, determined under the terms of the plan (including applicable limits under the Code) as in effect on the last day of the first taxable year beginning before January 1, 2010 without regard to any further services rendered by the individual after that date or any other events affecting the amount of, or the entitlement to, benefits (other than the applicable individual's election with respect to the time or form of an available benefit). For purposes of calculating the present value of remuneration under this paragraph (h)(2)(ii), reasonable actuarial assumptions and methods, determined as of the date the remuneration is valued, must be used. The present value as of the last day of the first taxable year beginning before January 1, 2010 is determined without regard to whether the remuneration under the nonaccount balance is subject to a substantial risk of forfeiture on or after that date.

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

(i) *Transition rules for certain deferred deduction remuneration—(1) Transition rule for deferred deduction remuneration attributable to services performed in taxable years of the covered health insurance provider beginning after December 31, 2009 and before January 1, 2013.* The deduction

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

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

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

payments are otherwise deductible by Z in 2015 and 2016, respectively.

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

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

in 2011, \$50,000 of deferred deduction remuneration in 2012, and the remaining \$100,000 of deferred deduction remuneration in 2013.

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

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

**Steven T. Miller,**

*Deputy Commissioner for Services and Enforcement.*

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