

apply with respect to compensation deferred under the plan before the earlier of:

(i) The date on which the last of the collective bargaining agreements terminates (determined without regard to any extension thereof after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**); or

(ii) The first day of the third calendar year beginning after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**.

(2) *Governmental plans*. If legislation is required to amend a governmental plan, these regulations will not apply to compensation deferred under that plan in taxable years ending before the day following the end of the second legislative session of the legislative body with the authority to amend the plan that begins after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**.

**John Dalrymple,**

*Deputy Commissioner for Services and Enforcement.*

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## DEPARTMENT OF THE TREASURY

### Internal Revenue Service

#### 26 CFR Part 1

[REG-123854-12]

RIN 1545-BL25

#### Application of Section 409A to Nonqualified Deferred Compensation Plans

**AGENCY:** Internal Revenue Service (IRS), Treasury.

**ACTION:** Partial withdrawal of notice of proposed rulemaking; notice of proposed rulemaking.

**SUMMARY:** This document contains proposed regulations that would clarify or modify certain specific provisions of the final regulations under section 409A (TD 9321, 72 FR 19234). This document also withdraws a specific provision of the notice of proposed rulemaking (REG-148326-05) published in the **Federal Register** on December 8, 2008 (73 FR 74380) regarding the calculation of amounts includible in income under section 409A(a)(1) and replaces that provision with revised proposed regulations. These proposed regulations would affect participants, beneficiaries, sponsors, and administrators of

nonqualified deferred compensation plans.

**DATES:** Comments and requests for a public hearing must be received by September 20, 2016.

**ADDRESSES:** Send submissions to: CC:PA:LPD:PR (REG-123854-12), Room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday, between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG-123854-12), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW., Washington, DC 20224 or sent electronically, via the Federal Rulemaking Portal at [www.regulations.gov](http://www.regulations.gov) (IRS REG-123854-12).

**FOR FURTHER INFORMATION CONTACT:** Concerning these proposed regulations under section 409A, Gregory Burns at (202) 927-9639, concerning submission of comments and/or requests for a hearing, Regina Johnson at (202) 317-6901 (not toll-free numbers).

#### SUPPLEMENTARY INFORMATION:

##### Background

Section 885 of the American Jobs Creation Act of 2004, Public Law 108-357 (118 Stat. 1418) (AJCA '04) added section 409A to the Internal Revenue Code (Code). Section 409A(a)(1)(A) generally provides that, if certain requirements are not met at any time during a taxable year, amounts deferred under a nonqualified deferred compensation plan for that year and all previous taxable years are currently includible in gross income to the extent not subject to a substantial risk of forfeiture and not previously included in gross income.

On April 17, 2007 (72 FR 19234), the Treasury Department and the IRS issued final regulations under section 409A (TD 9321), which include §§ 1.409A-1, 1.409A-2, 1.409A-3, and 1.409A-6 (the final regulations). The final regulations define certain terms used in section 409A and in the final regulations, set forth the requirements for deferral elections and for the time and form of payments under nonqualified deferred compensation plans, and address certain other issues under section 409A.

On December 8, 2008 (73 FR 74380), the Treasury Department and the IRS issued additional proposed regulations under section 409A (REG-148326-05), which include proposed § 1.409A-4 (the proposed income inclusion regulations). The proposed income inclusion regulations provide guidance regarding the calculation of amounts includible in income under section 409A(a)(1) and

the additional taxes imposed by section 409A with respect to service providers participating in certain nonqualified deferred compensation plans and other arrangements that do not comply with the requirements of section 409A(a).

#### Explanation of Provisions

##### I. Overview

The Treasury Department and the IRS have concluded that certain clarifications and modifications to the final regulations and the proposed income inclusion regulations will help taxpayers comply with the requirements of section 409A. These proposed regulations address certain specific provisions of the final regulations and the proposed income inclusion regulations and are not intended to propose a general revision of, or broad changes to, the final regulations or the proposed income inclusion regulations. The narrow and specific purpose of these proposed regulations should be taken into account when submitting comments on these proposed regulations. As provided in the section of this preamble titled "Proposed Effective Dates," taxpayers may rely upon these proposed regulations immediately.

These proposed regulations:

(1) Clarify that the rules under section 409A apply to nonqualified deferred compensation plans separately and in addition to the rules under section 457A.

(2) Modify the short-term deferral rule to permit a delay in payments to avoid violating Federal securities laws or other applicable law.

(3) Clarify that a stock right that does not otherwise provide for a deferral of compensation will not be treated as providing for a deferral of compensation solely because the amount payable under the stock right upon an involuntary separation from service for cause, or the occurrence of a condition within the service provider's control, is based on a measure that is less than fair market value.

(4) Modify the definition of the term "eligible issuer of service recipient stock" to provide that it includes a corporation (or other entity) for which a person is reasonably expected to begin, and actually begins, providing services within 12 months after the grant date of a stock right.

(5) Clarify that certain separation pay plans that do not provide for a deferral of compensation may apply to a service provider who had no compensation from the service recipient during the year preceding the year in which a separation from service occurs.

(6) Provide that a plan under which a service provider has a right to payment or reimbursement of reasonable attorneys' fees and other expenses incurred to pursue a bona fide legal claim against the service recipient with respect to the service relationship does not provide for a deferral of compensation.

(7) Modify the rules regarding recurring part-year compensation.

(8) Clarify that a stock purchase treated as a deemed asset sale under section 338 is not a sale or other disposition of assets for purposes of determining whether a service provider has a separation from service.

(9) Clarify that a service provider who ceases providing services as an employee and begins providing services as an independent contractor is treated as having a separation from service if, at the time of the change in employment status, the level of services reasonably anticipated to be provided after the change would result in a separation from service under the rules applicable to employees.

(10) Provide a rule that is generally applicable to determine when a "payment" has been made for purposes of section 409A.

(11) Modify the rules applicable to amounts payable following death.

(12) Clarify that the rules for transaction-based compensation apply to stock rights that do not provide for a deferral of compensation and statutory stock options.

(13) Provide that the addition of the death, disability, or unforeseeable emergency of a beneficiary who has become entitled to a payment due to a service provider's death as a potentially earlier or intervening payment event will not violate the prohibition on the acceleration of payments.

(14) Modify the conflict of interest exception to the prohibition on the acceleration of payments to permit the payment of all types of deferred compensation (and not only certain types of foreign earned income) to comply with bona fide foreign ethics or conflicts of interest laws.

(15) Clarify the provision permitting payments upon the termination and liquidation of a plan in connection with bankruptcy.

(16) Clarify other rules permitting payments in connection with the termination and liquidation of a plan.

(17) Provide that a plan may accelerate the time of payment to comply with Federal debt collection laws.

(18) Clarify and modify § 1.409A-4(a)(1)(ii)(B) of the proposed income inclusion regulations regarding the

treatment of deferred amounts subject to a substantial risk of forfeiture for purposes of calculating the amount includible in income under section 409A(a)(1).

(19) Clarify various provisions of the final regulations to recognize that a service provider can be an entity as well as an individual.

## II. Deferral of Compensation

### A. Section 457(f) and Section 457A Plans

Section 457(f) generally provides that compensation deferred under a plan of an eligible employer (as that term is defined under section 457) is included in gross income in the first taxable year in which there is no substantial risk of forfeiture of the rights to the compensation. The final regulations provide that a deferred compensation plan subject to section 457(f) may be a nonqualified deferred compensation plan for purposes of section 409A and that the rules of section 409A apply to deferred compensation plans separately and in addition to any requirements applicable to such plans under section 457(f).

Similarly, section 457A, which was enacted more than a year after publication of the final regulations, generally provides that any compensation deferred under a nonqualified deferred compensation plan of a nonqualified entity (as these terms are defined under section 457A) is includible in gross income when there is no substantial risk of forfeiture of the rights to the compensation. These proposed regulations clarify that a nonqualified deferred compensation plan under section 457A, like a deferred compensation plan under section 457(f), may be a nonqualified deferred compensation plan for purposes of section 409A and that the rules of section 409A apply to such a plan separately and in addition to any requirements applicable to the plan under section 457A.

### B. Short-Term Deferral Rule

The final regulations provide that a deferral of compensation does not occur for purposes of section 409A under a plan with respect to any payment that is not a deferred payment<sup>1</sup> provided that the service provider actually or constructively receives the payment on or before the later of: (1) The 15th day

<sup>1</sup> Under § 1.409A-1(b)(4)(i)(D), a payment is a deferred payment if it is made pursuant to a provision of a plan that provides for the payment to be made or completed on or after any date, or upon the occurrence of any event, that will or may occur later than the end of the applicable 2½ month period.

of the third month following the end of the service provider's first taxable year in which the right to the payment is no longer subject to a substantial risk of forfeiture, or (2) the 15th day of the third month following the end of the service recipient's first taxable year in which the right to the payment is no longer subject to a substantial risk of forfeiture (the applicable 2½ month period). A payment that meets these requirements of the short-term deferral rule (described more fully in § 1.409A-1(b)(4)) is referred to as a short-term deferral and is generally exempt from the requirements applicable to plans that provide for a deferral of compensation.

The final regulations provide that a payment that otherwise qualifies as a short-term deferral, but is made after the applicable 2½ month period, may continue to qualify as a short-term deferral if the payment is delayed for one of three reasons: (1) The taxpayer establishes that it was administratively impracticable for the service recipient to make the payment by the end of the applicable 2½ month period; (2) making the payment by the end of the applicable 2½ month period would have jeopardized the service recipient's ability to continue as a going concern; or (3) the service recipient reasonably anticipates that a deduction for the payment would not be permitted under section 162(m).

Similar exceptions apply under the general time and form of payment rules of section 409A. Under § 1.409A-3(d), a payment is treated as made on the date specified under the plan if the payment is delayed due to administrative impracticability or because making the payment would jeopardize the ability of the service recipient to continue as a going concern. Under § 1.409A-2(b)(7), a payment may be delayed to a date after the payment date designated in a plan without failing to meet the requirements of section 409A(a) if the service recipient reasonably anticipates that a deduction for the payment would not be permitted under section 162(m) or if making the payment would violate Federal securities laws or other applicable law. Together, these rules generally permit payments under section 409A to be delayed due to administrative impracticability or because making the payment would jeopardize the ability of the service recipient to continue as a going concern, the payment would not be deductible under section 162(m), or making the payment would violate Federal securities laws or other applicable law.

Some commenters have suggested that the exception for payments that would

violate Federal securities laws or other applicable law should also apply to payments that are intended to be short-term deferrals. These commenters have noted that the policy reasons for excusing a timely payment when the payment would violate Federal securities laws or other applicable law apply equally to the general time and form of payment rules under section 409A and the short-term deferral rule. In response to these comments, the Treasury Department and the IRS have determined that it is appropriate to extend this exception to the short-term deferral rule. Accordingly, these proposed regulations provide that a payment that otherwise qualifies as a short-term deferral, but is made after the end of the applicable 2½ month period, may still qualify as a short-term deferral if the service recipient reasonably anticipates that making the payment during the applicable 2½ month period will violate Federal securities laws or other applicable law and the payment is made as soon as reasonably practicable following the first date on which the service recipient anticipates or reasonably should anticipate that making the payment would not cause a violation. For this purpose, making a payment that would cause inclusion in gross income or the application of any penalty provision or other provision of the Code is not treated as a violation of applicable law.

### C. Stock Rights

#### 1. Service Recipient Stock

The final regulations provide that certain stock options and stock appreciation rights (collectively, stock rights) granted with respect to service recipient stock do not provide for the deferral of compensation. The term “service recipient stock” means a class of stock that, as of the date of grant, is common stock for purposes of section 305 and the regulations thereunder of a corporation that is an eligible issuer of service recipient stock. For this purpose, service recipient stock does not include any stock that is subject to a mandatory repurchase obligation (other than a right of first refusal), or a permanent put or call right, if the stock price under such right or obligation is based on a measure other than the fair market value (disregarding lapse restrictions) of the equity interest in the corporation represented by the stock.

Commenters have noted that employers often want to deter employees from engaging in behavior that could be detrimental to the employer and have customarily reduced the amount that an employee receives

under a stock rights arrangement if the employee is dismissed for cause or violates a noncompetition or nondisclosure agreement. These commenters have observed that this type of reduction is generally prohibited under the definition of service recipient stock in the final regulations but have argued that neither the statutory language nor the underlying policies of section 409A should prohibit a reduction under these circumstances. The Treasury Department and the IRS agree with these conclusions. Accordingly, these proposed regulations provide that a stock price will not be treated as based on a measure other than fair market value if the amount payable upon a service provider’s involuntary separation from service for cause, or the occurrence of a condition that is within the control of the service provider, such as the violation of a covenant not to compete or a covenant not to disclose certain information, is based on a measure that is less than fair market value.

#### 2. Eligible Issuer of Service Recipient Stock

Under the final regulations, the term “eligible issuer of service recipient stock” means the corporation or other entity for which the service provider provides direct services on the date of grant of the stock right and certain affiliated corporations or entities. Some commenters have asserted that this definition of “eligible issuer of service recipient stock” hinders employment negotiations because it prevents service recipients from granting stock rights to service providers before they are employed by the service recipient. In response to these comments, these proposed regulations provide that, if it is reasonably anticipated that a person will begin providing services to a corporation or other entity within 12 months after the date of grant of a stock right, and the person actually begins providing services to the corporation or other entity within 12 months after the date of grant (or, if services do not begin within that period, the stock right is forfeited), the corporation or other entity will be an eligible issuer of service recipient stock.

#### D. Separation Pay Plans

Under the final regulations, separation pay plans that provide for payment only upon an involuntary separation from service or pursuant to a window program do not provide for a deferral of compensation to the extent that they meet certain requirements. One of these requirements is that the separation pay generally not exceed two

times the lesser of (1) the service provider’s annualized compensation based upon the annual rate of pay for the service provider’s taxable year preceding the service provider’s taxable year in which the separation from service occurs, or (2) the limit under section 401(a)(17) for the year in which the service provider separates from service.

Some commenters have questioned whether this exception for separation pay plans is available for a service provider whose employment begins and ends during the same taxable year because the service provider was not employed by, and did not receive any compensation from, the service recipient for the taxable year preceding the taxable year in which the separation from service occurs. These proposed regulations clarify that the separation pay plan exception is available for service providers whose employment begins and ends in the same taxable year. In that circumstance, these proposed regulations provide that the service provider’s annualized compensation for the taxable year in which the service provider separates from service may be used for purposes of this separation pay plan exception if the service provider had no compensation from the service recipient in the taxable year preceding the year in which the service provider separates from service.

#### E. Employment-Related Legal Fees and Expenses

Under the final regulations, an arrangement does not provide for a deferral of compensation to the extent that it provides for amounts to be paid as settlements or awards resolving *bona fide* legal claims based on wrongful termination, employment discrimination, the Fair Labor Standards Act, or workers’ compensation statutes, including claims under applicable Federal, state, local, or foreign laws, or for reimbursements or payments of reasonable attorneys’ fees or other reasonable expenses incurred by the service provider related to such *bona fide* legal claims.

Commenters have requested guidance on the application of section 409A(a) to provisions commonly included in employment agreements that provide for the reimbursement of attorneys’ fees in connection with employment-related disputes and have asserted that there is no reason to distinguish between arrangements that provide for payment of reasonable attorneys’ fees and expenses for the types of legal claims currently specified in the final regulations and any other *bona fide*

legal claim with respect to the service relationship between a service provider and a service recipient. In response to these comments, these proposed regulations provide that an arrangement does not provide for a deferral of compensation to the extent that it provides for the payment or reimbursement of a service provider's reasonable attorneys' fees and other expenses incurred to enforce a claim by the service provider against the service recipient with respect to the service relationship.

#### F. Recurring Part-Year Compensation

After publication of the final regulations, commenters have expressed concerns about the application of section 409A to recurring part-year compensation. The final regulations define recurring part-year compensation as compensation paid for services rendered in a position that the service recipient and service provider reasonably anticipate will continue on similar terms and conditions in subsequent years, and will require services to be provided during successive service periods each of which comprises less than 12 months and each of which begins in one taxable year of the service provider and ends in the next taxable year. For example, a teacher providing services during school years comprised of 10 consecutive months would have recurring part-year compensation. See § 1.409A-2(a)(14). In general, commenters have asserted that section 409A should not apply to this situation because the amount being deferred from one taxable year to a subsequent taxable year is typically only a small amount and because most service providers who receive recurring part-year compensation (typically teachers and other educational workers) view an election to annualize this compensation as a cash flow decision, rather than a tax-deferral opportunity.

In response, the Treasury Department and the IRS issued Notice 2008-62 (2008-29 IRB 130), which provides that arrangements involving recurring part-year compensation do not provide for a deferral of compensation for purposes of section 409A or section 457(f) if: (1) The arrangement does not defer payment of any of the recurring part-year compensation beyond the last day of the 13th month following the beginning of the service period, and (2) the arrangement does not defer from one taxable year to the next taxable year the payment of more than the applicable dollar amount under section 402(g)(1)(B) in effect for the calendar year in which the service period begins (\$18,000 for 2016). Notice 2008-62 also

states that a conforming change is intended be made to the final regulations to reflect these rules.

Commenters have expressed concerns that Notice 2008-62 would not adequately address some teaching positions, such as college and university faculty members. They have noted that, depending on several variables (such as the calendar month in which a service provider commences service or the length of the service period), the dollar limitation in the notice may result in adverse tax consequences to service providers with annual compensation as low as \$80,000. Commenters have further observed that some of these arrangements are nonelective, and therefore some service providers cannot opt out of a recurring part-year compensation arrangement. In recognition that service recipients in the field of education frequently structure their pay plans to include recurring part-year compensation and that the main purpose of this design is to provide uninterrupted cash flow for service providers who do not work for a portion of the year, these proposed regulations modify the recurring part-year compensation rule. These proposed regulations provide that a plan or arrangement under which a service provider receives recurring part-year compensation that is earned over a period of service does not provide for the deferral of compensation if the plan does not defer payment of any of the recurring part-year compensation to a date beyond the last day of the 13th month following the first day of the service period for which the recurring part-year compensation is paid, and the amount of the service provider's recurring part-year compensation (not merely the amount deferred) does not exceed the annual compensation limit under section 401(a)(17) (\$265,000 for 2016) for the calendar year in which the service period commences. A conforming change is being made for purposes of section 457(f) under proposed section 457(f) regulations (REG-147196-07) that are also published in the Proposed Rules section of this issue of the **Federal Register**.

### III. Separation From Service Definition

#### A. Asset Purchase Transactions

The final regulations permit the seller and an unrelated buyer in an asset purchase transaction to specify whether a person who is a service provider of the seller immediately before the transaction is treated as separating from service if the service provider provides services to the buyer after and as a result of the transaction. Commenters have

asked whether this rule may be used with respect to a transaction that is treated as a deemed asset sale under section 338.

The provision of the final regulations giving buyers and sellers in asset transactions the discretion to treat employees as separating from service is based on the recognition that, while employees formally terminate employment with the seller and immediately recommence employment with the buyer in a typical asset transaction, the employees often experience no change in the type or level of services they provide. In a deemed asset sale under section 338, however, employees do not experience a termination of employment, formal or otherwise. Accordingly, the Treasury Department and the IRS have determined that it would be inconsistent with section 409A to permit the parties to a deemed asset sale to treat service providers as having separated from service upon the occurrence of the transaction. These proposed regulations affirm and make explicit that a stock purchase transaction that is treated as a deemed asset sale under section 338 is not a sale or other disposition of assets for purposes of this rule under section 409A.

#### B. Dual Status as Employee and Independent Contractor and Changes in Status From Employee to Independent Contractor (or Vice Versa)

The final regulations provide that an employee separates from service with an employer if the employee dies, retires, or otherwise has a termination of employment with the employer. Under the final regulations, a termination of employment generally occurs if the facts and circumstances indicate that the employer and employee reasonably anticipate that no further services would be performed after a certain date or that the level of *bona fide* services the employee would perform after that date (whether as an employee or as an independent contractor) would permanently decrease to no more than 20 percent of the average level of *bona fide* services performed (whether as an employee or an independent contractor) over the immediately preceding 36-month period (or if the employee has been providing services to the employer for less than 36 months, the full period of services). The final regulations provide that an independent contractor separates from service with a service recipient upon the expiration of the contract (or, if applicable, all contracts) under which services are performed for the service recipient if the expiration is

a good-faith and complete termination of the contractual relationship.

The final regulations also provide that if a service provider provides services both as an employee and an independent contractor of a service recipient, the service provider must separate from service both as an employee and as an independent contractor to be treated as having separated from service. The final regulations further provide that “[i]f a service provider ceases providing services as an independent contractor and begins providing services as an employee, or ceases providing services as an employee and begins providing services as an independent contractor, the service provider will not be considered to have a separation from service until the service provider has ceased providing services in both capacities.”

Some commenters have observed that the quoted sentence could be read to provide that a service provider who performs services for a service recipient as an employee, but who becomes an independent contractor for the same service recipient and whose anticipated level of services upon becoming an independent contractor are 20 percent or less than the average level of services performed during the immediately preceding 36-month period, would not have a separation from service because a complete termination of the contractual relationship with the service recipient has not occurred and, therefore, there is no separation from service as an independent contractor. Such a reading, however, would be inconsistent with the more specific rule that a service provider who is an employee separates from service if the employer and employee reasonably anticipate that the level of services to be performed after a certain date (whether as an employee or as an independent contractor) would permanently decrease to no more than 20 percent of the average level of services performed (whether as an employee or an independent contractor) over the immediately preceding 36-month period. To avoid potential confusion, these proposed regulations delete the quoted sentence from the regulations.

However, if a service provider, who performs services for a service recipient as an employee, becomes an independent contractor for the same service recipient but does not have a separation from service when he or she becomes an independent contractor (because at that time it is not reasonably anticipated that the level of services that would be provided by the service provider in the future would decrease to

no more than 20 percent of the average level of services performed over the immediately preceding 36-month period), the service provider will have a separation from service in the future when the service provider has a separation from service based on the rules that apply to independent contractors.

#### **IV. References to a Payment Being Made**

As discussed in section II.B of this preamble entitled “Short-term Deferral Rule,” the final regulations provide that a deferral of compensation does not occur under a plan if the service provider actually or constructively receives a payment that is not a deferred payment on or before the last day of the applicable 2½ month period. The final regulations further provide that, for this purpose, a payment is treated as actually or constructively received if the payment is includible in income, including if the payment is includible under the economic benefit doctrine, section 83, section 402(b), or section 457(f). Further, § 1.409A-2(b)(2) of the final regulations provides that, for purposes of subsequent changes in the time or form of payment, the term “payment” generally refers to each separately identified amount to which a service provider is entitled to payment under a plan on a determinable date. This section of the final regulations provides that a payment includes the provision of any taxable benefit, including cash or property. It also provides that a payment includes, but is not limited to, the transfer, cancellation, or reduction of an amount of deferred compensation in exchange for benefits under a welfare plan, a fringe benefit excludible from income, or any other benefit excludible from income. The final regulations, however, do not include a rule that is generally applicable for all purposes under section 409A to determine when a payment is made.

These proposed regulations add a generally applicable rule to determine when a payment has been made for all provisions of the regulations under section 409A. Under these proposed regulations, a payment is made, or the payment of an amount occurs, when any taxable benefit is actually or constructively received. Consistent with the final regulations, these proposed regulations provide that a payment includes a transfer of cash, any event that results in the inclusion of an amount in income under the economic benefit doctrine, a transfer of property includible in income under section 83, a contribution to a trust described in

section 402(b) at the time includible in income under section 402(b), and the transfer or creation of a beneficial interest in a section 402(b) trust at the time includible in income under section 402(b). In addition, a payment is made upon the transfer, cancellation, or reduction of an amount of deferred compensation in exchange for benefits under a welfare plan, a non-taxable fringe benefit, or any other nontaxable benefit.

The final regulations generally provide that the inclusion of an amount in income under section 457(f)(1)(A) is treated as a payment under section 409A for purposes of the short-term deferral rule under § 1.409A-1(b)(4), but is generally not treated as a payment for other purposes under section 409A. Commenters, however, have observed that this treatment of income inclusion under section 457(f)(1)(A) is inconsistent with the rules under section 409A that generally treat the inclusion of any amount in income as a payment for all purposes under section 409A. These commenters have also noted that a primary purpose of section 409A is to limit the ability of a service provider or service recipient to change the time at which deferred compensation is included in income after the time of payment is established and that the failure to treat income inclusion under section 457(f)(1)(A) as a payment would be inconsistent with this purpose. In response to these observations, these proposed regulations provide that the inclusion of an amount in income under section 457(f)(1)(A) is treated a payment for all purposes under section 409A.

Under this rule, if the plan provides for a deferral of compensation under section 409A: (1) Plan terms that specify the conditions to which the payment is subject and thus when a substantial risk of forfeiture lapses for purposes of section 457(f)(1)(A) (and, consequently, determine when an amount is includible in income) would be treated as plan terms providing for the payment of the amount includible in income, and (2) all rules under section 409A applicable to the payment of an amount would apply to the inclusion of an amount under section 457(f)(1)(A). A plan would not be a deferred compensation plan within the meaning of section 409A to the extent that the amounts payable under the plan are short-term deferrals under § 1.409A-1(b)(4). However, in certain limited circumstances, amounts includible in income under section 457(f)(1)(A) may not be short-term deferrals under § 1.409A-1(b)(4). For example, under the proposed section 457(f) regulations

(REG-147196-07), which are also published in the Proposed Rules section of this issue of the **Federal Register**, in certain circumstances conditioning a payment upon compliance with a noncompetition agreement will result in the payment being subject to a substantial risk of forfeiture for purposes of section 457(f)(1)(A), but that payment would not be treated as subject to a substantial risk of forfeiture for purposes of section 409A. In such cases, the amount payable at the end of the term of the noncompetition agreement upon compliance with the noncompete will be includible in income under section 457(f)(1)(A) only at the end of the term of the agreement under the section 457(f) regulations as proposed, but for purposes of section 409A will be deferred compensation (and not a short-term deferral), the payment of which is subject to the rules of section 409A.<sup>2</sup> See proposed § 1.457-12(e) (REG-147196-07); see also proposed § 1.457-12(a)(4) (REG-147196-07).

The Treasury Department and the IRS request comments on whether rules similar to those applicable to amounts included in income under section 457(f) should be adopted for amounts included in income under section 457A.

These proposed regulations also clarify that a transfer of property that is substantially nonvested (as defined under § 1.83-3(b)) to satisfy an obligation under a nonqualified deferred compensation plan is not a payment for purposes of section 409A unless the recipient makes an election under section 83(b) to include in income the fair market value of the property (disregarding lapse restrictions), less any amount paid for the property. These proposed regulations also make conforming clarifications to rules under § 1.409A-1(a)(4) regarding nonqualified deferred compensation plans subject to sections 457(f) and 457A, § 1.409A-1(b)(4) regarding the short-term deferral rule, and § 1.409A-2(b)(2) regarding the separate payment rule.

<sup>2</sup> There may also be instances in which a portion of an amount payable under an arrangement that is subject to section 457(f) is a short-term deferral for purposes of both section 409A and section 457(f)(1)(A), while another portion of the amount is a deferral of compensation for purposes of section 409A. For example, assume an arrangement subject to section 457(f) provides for payment of a specified dollar amount plus earnings upon separation from service, with vesting to occur when the service provider has completed three years of service. The specified dollar amount plus earnings to date is includible in income under section 457(f)(1)(A) when the service provider completes three years of service, and that amount will be a short-term deferral under section 409A if the service provider includes it in income at that time. The service provider's right to receive a payment of additional earnings accruing after the vesting date is a deferred compensation plan under section 409A.

## V. Permissible Payments

### A. Death

The final regulations provide that an amount deferred under a nonqualified deferred compensation plan may be paid only at a specified time or upon an event set forth under the regulations. One of the permissible events upon which an amount may be paid is the service provider's death. The final regulations also provide that a payment is treated as made upon a date specified under the plan (including at the time a specified event occurs) if the payment is made on that date or on a later date within the same taxable year of the service provider or, if later, by the 15th day of the third calendar month following the date specified under the plan, provided that the service provider is not permitted, directly or indirectly, to designate the taxable year of the payment.

Some commenters have questioned whether these and other rules in the final regulations applicable to amounts payable upon the death of a service provider also apply in the case of the death of a beneficiary who has become entitled to the payment of an amount due to a service provider's death. These proposed regulations clarify that the rules applicable to amounts payable upon the death of a service provider also apply to amounts payable upon the death of a beneficiary.

Also, some commenters have indicated that the time periods for the payment of amounts following death often are not long enough to resolve certain issues related to the death (for example, confirming the death and completing probate). In view of the practical issues that often arise following a death, these proposed regulations provide that an amount payable following the death of a service provider, or following the death of a beneficiary who has become entitled to payment due to the service provider's death, that is to be paid at any time during the period beginning on the date of death and ending on December 31 of the first calendar year following the calendar year during which the death occurs is treated as timely paid if it is paid at any time during this period. A plan is not required to specify any particular date within this period as the payment date and may rely on this rule if the plan provides that an amount will be paid at some time during this period, including if the plan provides that payment will be made upon death without defining the period for payment following death in any other manner, and including if the plan provides that payment will be made on a date within

this period determined in the discretion of the beneficiary. These proposed regulations further provide that a plan providing for the payment of an amount at any time during this specified period may be amended to provide for the payment of that amount (or the payment of that amount may be made without amending the plan) at any other time during this period (including a time determined in the discretion of a beneficiary) without failing to meet the requirements of the deferral election provisions of § 1.409A-2 or the permissible payment provisions of § 1.409A-3, including the prohibition on the acceleration of payments under § 1.409A-3(j). For example, a plan that provides for a payment to be made during the first calendar year beginning after the death of a service provider may be amended to provide for the payment of the amount (or the payment may be made under the plan without such amendment) at any time during the period beginning on the date of death and ending on December 31 of the first calendar year following the calendar year during which the death occurs. For additional rules concerning payments due upon a beneficiary's death, see section VI.A of this preamble.

### B. Certain Transaction-Based Compensation

The final regulations provide special rules for payments of transaction-based compensation. Transaction-based compensation payments are payments related to certain types of changes in control that (1) occur because a service recipient purchases its stock held by a service provider or because the service recipient or a third party purchases a stock right held by a service provider, or (2) are calculated by reference to the value of service recipient stock. Under the final regulations, transaction-based compensation may be treated as paid at a designated date or pursuant to a payment schedule that complies with the requirements of section 409A(a) if it is paid on the same schedule and under the same terms and conditions as apply to payments to shareholders generally with respect to stock of the service recipient pursuant to the change in control. Likewise, transaction-based compensation meeting these requirements will not fail to meet the requirements of the initial or subsequent deferral election rules under section 409A if it is paid not later than five years after the change in control event. These proposed regulations clarify that the special payment rules for transaction-based compensation apply to a statutory stock option or a stock right that did not otherwise provide for

deferred compensation before the purchase or agreement to purchase the stock right. Accordingly, the purchase (or agreement to purchase) such a statutory stock option or stock right in a manner consistent with these rules does not result in the statutory stock option or stock right being treated as having provided for the deferral of compensation from the original grant date.

## VI. Prohibition on Acceleration of Payments

### A. Payments to Beneficiaries Upon Death, Disability, or Unforeseeable Emergency

Under the final regulations, a prohibited acceleration of a payment does not result from the addition of death, disability, or unforeseeable emergency as a potentially earlier alternative payment event for an amount previously deferred. However, under the final regulations, this exception applies only with respect to a service provider's death, disability, or unforeseeable emergency and does not apply with respect to the death, disability, or unforeseeable emergency of a beneficiary who has become entitled to a payment due to the service provider's death. These proposed regulations provide that this exception also applies to the payment of deferred amounts upon the death, disability, or unforeseeable emergency of a beneficiary who has become entitled to payment due to a service provider's death. These proposed regulations also clarify that a schedule of payments (including payments treated as a single payment) that has already commenced prior to a service provider's or a beneficiary's death, disability, or unforeseeable emergency may be accelerated upon the death, disability, or unforeseeable emergency.

### B. Compliance With Bona Fide Foreign Ethics Laws or Conflicts of Interest Laws

Under the final regulations, a plan may provide for acceleration of the time or schedule of a payment, or a payment may be made under a plan, to the extent reasonably necessary to avoid the violation of a Federal, state, local, or foreign ethics or conflicts of interest law. However, with respect to a foreign ethics or conflicts of interest law, this exception applies only to foreign earned income from sources within the foreign country that promulgated the law. Commenters have suggested that this provision should not be limited to foreign earned income because the requirements of foreign ethics or conflicts of interest laws may affect both

the payment of foreign and United States earned income. These proposed regulations expand the scope of this provision to permit the acceleration of any nonqualified deferred compensation if the acceleration is reasonably necessary to comply with a *bona fide* foreign ethics or conflicts of interest law.

### C. Plan Terminations and Liquidations

Under the final regulations, a plan may provide for the acceleration of a payment made pursuant to the termination and liquidation of a plan under certain circumstances. Specifically, a plan may provide for the acceleration of a payment if the plan is terminated and liquidated within 12 months of a corporate dissolution taxed under section 331, or with the approval of a bankruptcy court pursuant to 11 U.S.C. 503(b)(1)(A) if certain other conditions are satisfied. The citation to 11 U.S.C. 503(b)(1)(A) is erroneous. These proposed regulations correct this provision by retaining the operative rule but deleting the section reference.

The final regulations also provide that a payment may be accelerated pursuant to a change in control event as described under § 1.409A-3(j)(4)(ix)(B) or in other circumstances provided certain requirements are satisfied, as described under § 1.409A-3(j)(4)(ix)(C). To terminate a plan pursuant to § 1.409A-3(j)(4)(ix)(C), the final regulations provide that the service recipient must terminate and liquidate all plans sponsored by the service recipient that would be aggregated with the terminated plan under the plan aggregation rules under § 1.409A-1(c) of the final regulations if the same service provider had deferrals of compensation under all such plans. The final regulations also provide that for three years following the date on which the service recipient took all necessary action to irrevocably terminate and liquidate the plan the service recipient cannot adopt a new plan that would be aggregated with the terminated and liquidated plan if the same service provider participated in both plans. Some commenters have asked whether these rules mean that only the plans of a particular category in which a particular service provider actually participates must be terminated if a plan in which that service provider participates is terminated.

The plan aggregation rules under § 1.409A-1(c)(2) of the final regulations identify nine different types of nonqualified deferred compensation plans—account balance plans providing for elective deferrals, account balance plans that do not provide for elective

deferrals, nonaccount balance plans, separation pay plans, plans providing for in-kind benefits or reimbursements, split-dollar plans, foreign earned income plans, stock right plans, and plans that are not any of the foregoing. All plans of the same type in which the same service provider participates are treated as a single plan. The rule set forth under § 1.409A-3(j)(4)(ix)(C) that requires the termination and liquidation of all plans sponsored by the service recipient that would be aggregated with the terminated plan “if the same service provider had deferrals of compensation” under all of those plans is intended to require the termination of all plans in the same plan category sponsored by the service recipient. The reference to the “same service provider” having deferrals of compensation under all of those plans refers to participation of a hypothetical service provider in all such plans, which would be required to aggregate all of the plans under the section 409A plan aggregation rules.

The Treasury Department and the IRS have concluded that the meaning of the plan termination rule under § 1.409A-3(j)(4)(ix)(C) is not ambiguous. However, to address the questions raised by commenters, these proposed regulations further clarify that the acceleration of a payment pursuant to this rule is permitted only if the service recipient terminates and liquidates all plans of the same category that the service recipient sponsors, and not merely all plans of the same category in which a particular service provider actually participates. These proposed regulations also clarify that under this rule, for a period of three years following the termination and liquidation of a plan, the service recipient cannot adopt a new plan of the same category as the terminated and liquidated plan, regardless of which service providers participate in the plan.

### D. Offset Provisions

The final regulations provide that the payment of an amount as a substitute for a payment of deferred compensation is generally treated as a payment of the deferred compensation. They also provide that when the payment of an amount results in an actual or potential reduction of, or current or future offset to, an amount of deferred compensation, the payment is a substitute for the deferred compensation. Further, the final regulations provide that if a service provider's right to deferred compensation is made subject to anticipation, alienation, sale, transfer, assignment, pledge, encumbrance, attachment, or garnishment by the service provider's creditors, the deferred

compensation is treated as having been paid. Under certain circumstances, these provisions may result in an amount being paid (or treated as paid) before the payment date or event specified in the plan in violation of the prohibition on the acceleration of payments under section 409A. The final regulations, however, include a de minimis exception to these rules pursuant to which a plan may provide for the acceleration of the time or schedule of a payment, or a payment may be made under a plan, in satisfaction of a debt of the service provider if the debt is incurred in the ordinary course of the service relationship, the entire offset in any taxable year does not exceed \$5,000, and the offset is taken at the same time and in the same amount as the debt otherwise would have been due from the service provider.

Stakeholders have observed that the prohibition on offsets may conflict with certain laws regarding debt collection by the Federal government (for example, 31 U.S.C. 3711, *et. seq.*), and that the exception for small debts is insufficient to permit the enforcement of these laws. Because these laws would effectively prevent certain government entities from providing nonqualified deferred compensation in a manner that complies with the requirements of section 409A(a) and because of the limited applicability of Federal debt collection laws, the Treasury Department and the IRS have determined that it is appropriate to expand the current exception to the prohibition on accelerated payments for certain offsets to permit a plan to provide for the acceleration of the time or schedule of a payment, or to make a payment, to the extent reasonably necessary to comply with Federal laws regarding debt collection.

#### **VII. Amount Includible in Income Under Section 409A**

The proposed income inclusion regulations provide that the amount includible in income for a taxable year if a nonqualified deferred compensation plan fails to meet the requirements of section 409A(a) at any time during that taxable year equals the excess of (1) the total amount deferred under the plan for that taxable year, including any payments under the plan during that taxable year, over (2) the portion of that amount, if any, that is either subject to a substantial risk of forfeiture or has been previously included in income. The proposed income inclusion regulations, however, include an anti-abuse provision under § 1.409A-4(a)(1)(ii)(B), which provides that an

amount otherwise subject to a substantial risk of forfeiture for purposes of determining the amount includible in income under a plan will be treated as not subject to a substantial risk of forfeiture for these purposes if the facts and circumstances indicate that a service recipient has a pattern or practice of permitting impermissible changes in the time or form of payment with respect to nonvested deferred amounts under one or more nonqualified deferred compensation plans and either (i) an impermissible change in the time or form of payment applies to the amount or (ii) the facts and circumstances indicate that the amount would be affected by the pattern or practice.

Although these rules permit the correction of certain plan provisions that fail to comply with the requirements of section 409A(a) while amounts are nonvested without including the amounts in income or incurring an additional tax, they were not intended to allow service recipients to change time or form of payment provisions that otherwise meet the requirements of section 409A(a) in a manner that fails to comply with section 409A(a), and they were not intended to permit service recipients to create errors in nonqualified deferred compensation plans with respect to nonvested amounts with the intention of using those errors as a pretext for establishing or changing a time or form of payment in a manner that fails to comply with section 409A(a). Accordingly, these proposed regulations clarify and modify the anti-abuse rule under § 1.409A-4(a)(1)(ii)(B) of the proposed income inclusion regulations to preclude changes of this nature.

First, these proposed regulations clarify that a deferred amount that is otherwise subject to a substantial risk of forfeiture is treated as not subject to a substantial risk of forfeiture for a service provider's taxable year during which there is a change in a plan provision (including an initial deferral election provision) that is not otherwise permitted under section 409A and the final regulations and that affects the time or form of payment of the amount if there is no reasonable, good faith basis for concluding that the original provision failed to meet the requirements of section 409A(a) and that the change is necessary to bring the plan into compliance with the requirements of section 409A(a).

Second, these proposed regulations provide examples of the types of facts and circumstances that indicate whether a service recipient has a pattern or practice of permitting impermissible

changes in the time or form of payment with respect to nonvested deferred amounts under one or more plans. If the service recipient has such a pattern or practice that would affect a nonvested deferred amount, that amount is treated as not subject to a substantial risk of forfeiture. The facts and circumstances include: Whether a service recipient has taken commercially reasonable measures to identify and correct substantially similar failures promptly upon discovery; whether substantially similar failures have occurred with respect to nonvested deferred amounts to a greater extent than with respect to vested deferred amounts; whether substantially similar failures occur more frequently with respect to newly adopted plans; and whether substantially similar failures appear intentional, are numerous, or repeat common past failures that have since been corrected.

Third, these proposed regulations provide that, to the extent generally applicable guidance regarding the correction of section 409A failures prescribes a particular correction method (or methods) for a type of plan failure, that correction method (or one of the permissible correction methods) must be used if a service recipient chooses to correct that type of a failure with respect to a nonvested deferred amount. In addition, these proposed regulations provide that substantially similar failures affecting nonvested deferred amounts must be corrected in substantially the same manner.

A service recipient correcting a plan failure affecting a nonvested deferred amount is not required, solely with respect to the nonvested deferred amount, to comply with any requirement under generally applicable guidance regarding the correction of section 409A failures that is unrelated to the method for correcting the failure, such as general eligibility requirements, income inclusion, additional taxes, premium interest, or information reporting by the service recipient or service provider. Accordingly, a service recipient may amend a noncompliant plan term in a manner permitted under applicable correction guidance even though the failure may not have been eligible for correction under that guidance (for example, due to applicable timing requirements). In addition, the portion of the nonvested deferred amount that is affected by the correction is not subject to income inclusion, additional taxes, or applicable premium interest under section 409A(a)(1), and neither the service recipient nor the service provider is required to notify the IRS of



the correction. For a description of the currently available corrections methods, see Notice 2008–113 (2008–51 IRB 1305), Notice 2010–6 (2010–3 IRB 275), and Notice 2010–80 (2010–51 IRB 853).

### VIII. Individual and Entity Service Providers

Under the final regulations, the term service provider includes an individual, corporation, subchapter S corporation, partnership, personal service corporation, noncorporate entity that would be a personal service corporation if it were a corporation, qualified personal service corporation, and noncorporate entity that would be a qualified personal service corporation if it were a corporation. These proposed regulations clarify §§ 1.409A–1(b)(5)(vi)(A), 1.409A–1(b)(5)(vi)(E), 1.409A–1(b)(5)(vi)(F), and 1.409A–3(i)(5)(iii) of the final regulations to reflect that a service provider can be an entity as well as an individual. These proposed regulations also clarify § 1.409A–1(b)(3) of the final regulations to correct an erroneous reference to “service provider” that should be “service recipient.”

### Proposed Effective Dates

#### *General Applicability Date for Amendments to Final Regulations*

The provisions of these proposed regulations amending the final regulations are proposed to be applicable on or after the date on which they are published as final regulations in the **Federal Register**. For periods before this date, the existing final regulations and other applicable guidance apply (without regard to these proposed regulations). The applicability date for the existing final regulations in § 1.409A–6(b) is accordingly amended to reflect extension of certain transition relief through 2008 under Notice 2007–86, 2007–46 IRB 990. Taxpayers may, however, rely on these proposed regulations before they are published as final regulations, and until final regulations are published the IRS will not assert positions that are contrary to the positions set forth in these proposed regulations.

Certain provisions of these proposed amendments to the final regulations are not intended as substantive changes to the current requirements under section 409A. Accordingly, the Treasury Department and the IRS have concluded that the following positions may not properly be taken under the existing final regulations: (1) That the transfer of restricted stock for which no section 83(b) election is made or the transfer of a stock option that does not have a

readily ascertainable fair market value would result in a payment under a plan; (2) that a contribution to a section 402(b) trust includible in income under section 402(b) to fund an obligation under a plan would not result in a payment under a plan; (3) that a stock purchase treated as a deemed asset sale under section 338 is a sale or other disposition of assets for purposes of determining when a service provider separates from service as a result of an asset purchase transaction; or (4) that the exception to the prohibition on acceleration of a payment upon a termination and liquidation of a plan pursuant to § 1.409A–3(j)(4)(ix)(C) applies if the service recipient terminates and liquidates only the plans of the same category in which a particular service provider participates, rather than all plans of the same category that the service recipient sponsors.

#### *General Applicability Date for Amendments to Proposed Income Inclusion Regulations*

The proposed income inclusion regulations are proposed to be applicable on or after the date on which they are published as final regulations in the **Federal Register**. Notice 2008–115 provides that, until the Treasury Department and the IRS issue further guidance, compliance with the provisions of the proposed income inclusion regulations with respect to the calculation of the amount includible in income under section 409A(a)(1) and the calculation of the additional taxes under section 409A(a)(1) will be treated as compliance with the requirements of section 409A(a), provided that the taxpayer complies with all of the provisions of the proposed regulations. Until the Treasury Department and the IRS issue further guidance, taxpayers may rely on the proposed income inclusion regulations, as modified by the amendment of § 1.409A–4(a)(1)(ii)(B) in these proposed regulations, for purposes of calculating the amount includible in income under section 409A(a)(1) (including the identification and treatment of deferred amounts subject to a substantial risk of forfeiture) and the calculation of the additional taxes under section 409A(a)(1), and the IRS will not assert positions with respect to periods before the date final regulations are published in the **Federal Register** that are contrary to the positions set forth in the proposed income inclusion regulations as amended by these proposed regulations.

#### *Special Applicability Dates for Amendments to Recurring Part-Year Compensation Rules*

The rules set forth in these proposed regulations regarding recurring part-year compensation are proposed to be applicable on and after the date on which these proposed regulations are published as final regulations in the **Federal Register**. However, taxpayers may rely on either the rules in these proposed regulations or the rules in Notice 2008–62 relating to recurring part-year compensation for the taxable year in which these proposed regulations are published as final regulations and all prior taxable years.

### Effect on Other Documents

These proposed regulations do not affect the applicability of other guidance issued with respect to section 409A, including Notice 2008–115, except that, for the permitted reliance on the proposed income inclusion regulations, these proposed regulations withdraw § 1.409A–4(a)(1)(ii)(B) of the proposed income inclusion regulations and replace it with a new § 1.409A–4(a)(1)(ii)(B).

### Statement of Availability of IRS Documents

IRS Revenue Procedures, Revenue Rulings notices, and other guidance cited in this document are published in the Internal Revenue Bulletin (or Cumulative Bulletin) and are available from the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402, or by visiting the IRS Web site at <http://www.irs.gov>. (See § 601.601(d)(2)(ii)(b) of this chapter.)

### Special Analyses

Certain IRS regulations, including this one, are exempt from the requirements of Executive Order 12866, as supplemented and reaffirmed by Executive Order 13563. Therefore, a regulatory impact 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 proposed regulations. It is hereby certified that the collection of information in these proposed regulations would not have a significant impact on a substantial number of small entities. This certification is based on the fact that these proposed regulations only provide guidance on how to satisfy existing collection of information requirements. Accordingly, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Code, these proposed regulations have 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 comments that are submitted timely to the IRS as prescribed in this preamble under the ADDRESSES heading. The Treasury Department and the IRS request comments on all aspects of the rules proposed by these proposed regulations. All comments will be available at www.regulations.gov or upon request. A public hearing may be scheduled if requested by any person who timely submits comments. If a public hearing is scheduled, notice of the date, time and place for the hearing will be published in the Federal Register.

Drafting Information

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

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Partial Withdrawal of Notice of Proposed Rulemaking

Accordingly, under the authority of 26 U.S.C. 7805, § 1.409A-4(a)(1)(ii)(B) of the notice of proposed rulemaking (REG-148326-05) that was published in the Federal Register on December 8, 2008 (73 FR 74380) is withdrawn.

Proposed Amendments to the Regulations

Accordingly, 26 CFR parts 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 1.409A-0 is amended by:

- 1. Revising the entry for § 1.409A-1 by adding paragraph (b)(13).
2. Redesignating paragraph (q) as paragraph (r), and revising paragraph (q) in § 1.409A-1.
3. Revising the entry to paragraph (d) in § 1.409A-3.

4. Revising the entry to (j)(4)(xiii) in § 1.409A-3.

The revisions and addition read as follows:

§ 1.409A-0 Table of contents.

\* \* \* \* \*

§ 1.409A-1 Definitions and covered plans.

\* \* \* \* \*

(b) \* \* \*

(13) Recurring part-year compensation.

\* \* \* \* \*

(q) References to a payment being made.

(r) Application of definitions and rules.

\* \* \* \* \*

§ 1.409A-3 Permissible Payments.

\* \* \* \* \*

(d) \* \* \*

(1) In general.

(2) Payments due following death.

\* \* \* \* \*

(j) \* \* \*

(4) \* \* \*

(xiii) Certain offsets.

(A) De minimis offset.

(B) Compliance with Federal debt collection laws.

\* \* \* \* \*

Par. 3. Section 1.409A-1 is amended by:

- 1. Revising paragraph (a)(4).
2. Revising the first sentence of paragraph (b)(1).
3. Revising paragraphs (b)(3) and (b)(4)(i)(B).
4. Revising paragraph (b)(4)(ii).
5. Adding a last sentence to paragraph (b)(5)(iii)(A).
6. Revising paragraph (b)(5)(iii)(E)(1).
7. Revising the first sentence of paragraph (b)(5)(vi)(A).
8. Revising paragraphs (b)(5)(vi)(E) and (b)(5)(vi)(F).
9. Revising paragraph (b)(9)(iii)(A).
10. Adding a last sentence to paragraph (b)(11).
11. Adding paragraph (b)(13).
12. Revising paragraphs (h)(4) and (h)(5).
13. Redesignating paragraph (q) as paragraph (r) and revising paragraphs (q) and (r).

The revisions and additions read as follows:

§ 1.409A-1 Definitions and covered plans.

\* \* \* \* \*

(a) \* \* \*

(4) Section 457(f) and section 457A plans. A deferred compensation plan under section 457(f) or a nonqualified deferred compensation plan under section 457A may be a nonqualified deferred compensation plan for

purposes of this paragraph (a). The rules of section 409A apply to nonqualified deferred compensation plans separately and in addition to any requirements applicable to such plans under section 457(f) or section 457A. In addition, nonelective deferred compensation of non-employees described in section 457(e)(12) and a grandfathered plan or arrangement described in § 1.457-2(k)(4) may be a nonqualified deferred compensation plan for purposes of this paragraph (a). The term nonqualified deferred compensation plan does not include a length of service award to a bona fide volunteer under section 457(e)(11)(A)(ii).

\* \* \* \* \*

(b) \* \* \*

(1) \* \* Except as otherwise provided in paragraphs (b)(3) through (b)(13) of this section, a plan provides for the deferral of compensation if, under the terms of the plan and the relevant facts and circumstances, the service provider has a legally binding right during a taxable year to compensation that, pursuant to the terms of the plan, is or may be payable to (or on behalf of) the service provider in a later taxable year.

\* \* \* \* \*

\* \* \* \* \*

(3) Compensation payable pursuant to the service recipient's customary payment timing arrangement. A deferral of compensation does not occur solely because compensation is paid after the last day of the service provider's taxable year pursuant to the timing arrangement under which the service recipient normally compensates service providers for services performed during a payroll period described in section 3401(b), or with respect to a non-employee service provider, a period not longer than the payroll period described in section 3401(b) or if no such payroll period exists, a period not longer than the earlier of the normal timing arrangement under which the service recipient normally compensates non-employee service providers or 30 days after the end of the service provider's taxable year.

(4) \* \* \*

(i) \* \* \*

(B) A payment is treated as actually or constructively received for purposes of this paragraph (b)(4) if it is made in accordance with the rules in § 1.409A-1(q).

\* \* \* \* \*

(ii) Certain delayed payments. A payment that otherwise qualifies as a short-term deferral under paragraph (b)(4)(i) of this section but is made after the applicable 2 1/2 month period may continue to qualify as a short-term

deferral if the taxpayer establishes that it was administratively impracticable for the service recipient to make the payment by the end of the applicable 2½ month period and, as of the date upon which the legally binding right to the compensation arose, such impracticability was unforeseeable, or the taxpayer establishes that making the payment by the end of the applicable 2½ month period would have jeopardized the ability of the service recipient to continue as a going concern, and provided further that the payment is made as soon as administratively practicable or as soon as the payment would no longer have such effect. For purposes of this paragraph (b)(4)(ii), an action or failure to act of the service provider or a person under the service provider's control, such as a failure to provide necessary information or documentation, is not an unforeseeable event. In addition, a payment that otherwise qualifies as a short-term deferral under paragraph (b)(4)(i) of this section but is made after the applicable 2½ month period may continue to qualify as a short-term deferral if the taxpayer establishes that the service recipient reasonably anticipated that the service recipient's deduction with respect to such payment otherwise would not be permitted by application of section 162(m), and, as of the date the legally binding right to the payment arose, a reasonable person would not have anticipated the application of section 162(m) at the time of the payment, and provided further that the payment is made as soon as reasonably practicable following the first date on which the service recipient anticipates or reasonably should anticipate that, if the payment were made on such date, the service recipient's deduction with respect to such payment would no longer be restricted due to the application of section 162(m). Further, a payment that otherwise qualifies as a short-term deferral under paragraph (b)(4)(i) of this section but is made after the applicable 2½ month period may continue to qualify as a short-term deferral if the taxpayer establishes that the service recipient reasonably anticipated that making the payment by the end of the applicable 2½ month period would have violated Federal securities laws or other applicable law, provided that the payment is made as soon as reasonably practicable following the first date on which the service recipient anticipates or reasonably should anticipate that making the payment would not cause such violation. The making of a payment that would cause inclusion in gross income

or the application of any penalty provision or other provision of the Internal Revenue Code is not treated as a violation of applicable law. For additional rules applicable to certain transaction-based compensation, see § 1.409A-3(i)(5)(iv)(A).

\* \* \* \* \*

(5) \* \* \*

(iii) \* \* \*

(A) \* \* \* The stock price will not be treated as based on a measure other than the fair market value to the extent that the amount payable upon the service provider's involuntary separation from service for cause, or the occurrence of a condition within the service provider's control such as noncompliance with a noncompetition or nondisclosure agreement (whether or not the condition is specified at the time the stock right is granted), is based on a measure that results in a payment of less than fair market value.

\* \* \* \* \*

(E) *Eligible issuer of service recipient stock*—(1) *In general.* The term *eligible issuer of service recipient stock* means the corporation or other entity for which the service provider provides direct services on the date of grant of the stock right or a corporation or other entity for which it is reasonably anticipated that the service provider will begin providing direct services within 12 months after the date of grant, and any corporation or other entity (a related corporation or other entity) in a chain of corporations or other entities in which each corporation or other entity has a controlling interest in another corporation or other entity in the chain, ending with the corporation or other entity that has a controlling interest in the corporation or other entity for which the service provider provides direct services on the date of grant of the stock right or the corporation or other entity for which it is reasonably anticipated that the service provider will begin providing direct services within 12 months after the date of grant. If it is reasonably anticipated that a service provider will begin providing services for a corporation or other entity within 12 months after the date of grant, that corporation or other entity (or a related corporation or other entity) will be an eligible issuer of service recipient stock only if the services in fact commence within 12 months after the date of grant and the stock otherwise is service recipient stock at the time the services begin or, if services do not commence within that 12 month period, the right is forfeited. For this purpose, the term *controlling interest* has the same meaning as provided in § 1.414(c)–

2(b)(2)(i), substituting the language “at least 50 percent” for “at least 80 percent” each place it appears in § 1.414(c)–2(b)(2)(i). In addition, if the use of such stock with respect to the grant of a stock right to a service provider is based upon legitimate business criteria, the term *controlling interest* has the same meaning as provided in § 1.414(c)–2(b)(2)(i), substituting the language “at least 20 percent” for “at least 80 percent” each place it appears in § 1.414(c)–2(b)(2)(i). For purposes of determining ownership of an interest in an organization, the rules of §§ 1.414(c)–3 and 1.414(c)–4 apply. The determination of whether a grant is based on legitimate business criteria is based on the facts and circumstances, focusing primarily on whether there is a sufficient nexus between the service provider and the issuer of the stock right so that the grant serves a legitimate non-tax business purpose other than simply providing compensation to the service provider that is excluded from the requirements of section 409A. For example, when stock of a corporation that owns an interest in a joint venture involving an operating business is granted to service providers of the joint venture who are former service providers of such corporation, that use is generally based upon legitimate business criteria, and therefore could be service recipient stock with respect to such service providers if the corporation owns at least 20 percent of the joint venture and the other requirements of this paragraph (b)(5)(iii) are met. Similarly, the legitimate business criteria requirement generally would be met if the corporate venturer issued such a right to a service provider of the joint venture who it reasonably expected would become a service provider of the corporate venturer. However, if a service provider has no real nexus with a corporate venturer, such as generally happens when the corporate venturer is a passive investor in the service recipient joint venture, a stock right issued to the service provider on the investor corporation's stock generally would not be based upon legitimate business criteria. Similarly, if a corporation holds only a minority interest in an entity that in turn holds a minority interest in the entity for which the service provider performs services, such that the corporation holds only an insubstantial indirect interest in the entity receiving the services, legitimate business criteria generally would not exist for issuing a stock right on the corporation's stock to the service provider.

\* \* \* \* \*

(vi) \* \* \*

(A) \* \* \* The term *option* means the right or privilege of a person to purchase stock from a corporation by virtue of an offer of the corporation continuing for a stated period of time, whether or not irrevocable, to sell such stock at a price determined under paragraph (b)(5)(vi)(D) of this section, such person being under no obligation to purchase.

(E) *Exercise*. The term *exercise*, when used in reference to an option, means the act of acceptance by the holder of the option of the offer to sell contained in the option. In general, the time of exercise is the time when there is a sale or a contract to sell between the corporation and the holder. A promise to pay the exercise price is not an exercise of the option unless the holder of the option is subject to personal liability on such promise. An agreement or undertaking by the service provider to make payments under a stock purchase plan is not the exercise of an option to the extent the payments made remain subject to the withdrawal by or refund to the service provider.

(F) *Transfer*. The term *transfer*, when used in reference to the transfer to a person of a share of stock pursuant to the exercise of an option, means the transfer of ownership of such share, or the transfer of substantially all the rights of ownership. Such transfer must, within a reasonable time, be evidenced on the books of the corporation. A transfer may occur even if a share of stock is subject to a substantial risk of forfeiture or is not otherwise transferable immediately after the date of exercise. A transfer does not fail to occur merely because, under the terms of the arrangement, the person may not dispose of the share for a specified period of time, or the share is subject to a right of first refusal or a right to acquire the share at the share's fair market value at the time of the sale.

(9) \* \* \*

(iii) \* \* \*

(A) The separation pay (other than amounts described in paragraphs (b)(9)(iv) and (v) of this section) does not exceed two times the lesser of—

(1) The service provider's annualized compensation based upon the annual rate of pay for services provided to the service recipient for the service provider's taxable year preceding the taxable year in which the service provider has a separation from service with such service recipient (or for the taxable year in which the service provider has a separation from service if the service provider had no

compensation from the service recipient in the preceding taxable year), adjusted for any increase during that year that was expected to continue indefinitely if the service provider had not separated from service; or

(2) The maximum amount that may be taken into account under a qualified retirement plan pursuant to section 401(a)(17) for the calendar year in which the service provider has a separation from service.

(11) \* \* \* In addition, a plan does not provide for a deferral of compensation for purposes of this paragraph (b) to the extent it provides for a payment of reasonable attorneys' fees or other reasonable expenses incurred by the service provider to enforce any *bona fide* legal claim against the service recipient with respect to the service relationship between the service provider and the service recipient.

(13) *Recurring part-year compensation*. A plan in which a service provider participates that provides for the payment of recurring part-year compensation (as defined in § 1.409A-2(a)(14)), whether or not at the service provider's election, does not provide for a deferral of compensation for purposes of this paragraph (b) if the plan does not defer payment of any of the recurring part-year compensation to a date beyond the last day of the 13th month following the first day of the service period for which the recurring part-year compensation is paid, and the amount of the service provider's recurring part-year compensation does not exceed the annual compensation limit under section 401(a)(17) for the calendar year in which the service period commences.

(h) \* \* \*

(4) *Asset purchase transactions*. If as part of a sale or other disposition of assets by one service recipient (seller) to an unrelated service recipient (buyer), a service provider of the seller would otherwise experience a separation from service with the seller, the seller and the buyer may retain the discretion to specify, and may specify, whether a service provider providing services to the seller immediately before the asset purchase transaction and providing services to the buyer after and as a result of the asset purchase transaction has experienced a separation from service for purposes of this paragraph (h), provided that the asset purchase transaction results from *bona fide*, arm's length negotiations, all service providers

providing services to the seller immediately before the asset purchase transaction and providing services to the buyer after and as a result of the asset purchase transaction are treated consistently (regardless of position at the seller) for purposes of applying the provisions of any nonqualified deferred compensation plan, and such treatment is specified in writing no later than the closing date of the asset purchase transaction. For purposes of this paragraph (h)(4), references to a sale or other disposition of assets, or an asset purchase transaction, refer only to a transfer of substantial assets, such as a plant or division or substantially all of the assets of a trade or business, and do not refer to a stock purchase treated as a deemed asset sale under section 338. For purposes of this paragraph (h)(4), whether a service recipient is related to another service recipient is determined under the rules provided in paragraph (f)(2)(ii) of this section.

(5) *Dual status*. If a service provider provides services both as an employee of a service recipient and as an independent contractor of the service recipient, the service provider must separate from service both as an employee and as an independent contractor to be treated as having separated from service. Notwithstanding the foregoing, if a service provider provides services both as an employee of a service recipient and as a member of the board of directors of a corporate service recipient (or an analogous position with respect to a non-corporate service recipient), the services provided as a director are not taken into account in determining whether the service provider has a separation from service as an employee for purposes of a nonqualified deferred compensation plan in which the service provider participates as an employee that is not aggregated with any plan in which the service provider participates as a director under paragraph (c)(2)(ii) of this section. In addition, if a service provider provides services both as an employee of a service recipient and as a member of the board of directors of a corporate service recipient (or an analogous position with respect to a non-corporate service recipient), the services provided as an employee are not taken into account in determining whether the service provider has a separation from service as a director for purposes of a nonqualified deferred compensation plan in which the service provider participates as a director that is not aggregated with any plan in which the service provider participates as an

employee under paragraph (c)(2)(ii) of this section.

\* \* \* \* \*

(q) *References to a payment being made.* A payment is made or an amount is paid or received when any taxable benefit is actually or constructively received, which includes a transfer of cash, a transfer of property includible in income under section 83, any other event that results in the inclusion in income under the economic benefit doctrine, a contribution to a trust described in section 402(b) at the time includible in income under section 402(b), a transfer or creation of a beneficial interest in a section 402(b) trust at the time includible in income under section 402(b), and the inclusion of an amount in income under 457(f)(1)(A). In addition, a payment is made or an amount is paid or received upon the transfer, cancellation, or reduction of an amount of deferred compensation in exchange for benefits under a welfare benefit plan, a fringe benefit excludible under section 119 or section 132, or any other benefit that is excludible from gross income. Notwithstanding the foregoing, the occurrence of any of the following events is not a payment:

(1) a grant of an option that does not have a readily ascertainable fair market value (as defined under § 1.83-7(b));

(2) a transfer of property (including an option that has a readily ascertainable fair market value) that is substantially nonvested (as defined under § 1.83-3(b)) with respect to which the service provider does not make a valid election under section 83(b); or

(3) a contribution to a trust described in section 402(b) or a transfer or creation of a beneficial interest in a section 402(b) trust unless and until the amount is includible in income under section 402(b).

(r) *Application of definitions and rules.* The definitions and rules set forth in paragraphs (a) through (q) of this section apply for purposes of section 409A, this section, and §§ 1.409A-2 through 1.409A-6.

■ **Par. 4.** Section 1.409A-2 is amended by revising paragraph (b)(2)(i) to read as follows:

**§ 1.409A-2 Deferral elections.**

\* \* \* \* \*

(b) \* \* \*

(2) *Definitions of payments for purposes of subsequent changes in the time or form of payment—(i) In general.* Except as provided in paragraphs (b)(2)(ii) and (iii) of this section, the term *payment* refers to each separately identified amount to which a service provider is entitled to payment under a

plan on a determinable date, and includes amounts applied for the benefit of the service provider. An amount is separately identified only if the amount may be objectively determined under a nondiscretionary formula. For example, an amount identified as 10 percent of the account balance as of a specified payment date would be a separately identified amount. The determination of whether a payment is or has been made for purposes of this paragraph (b) is made in accordance with the rules in § 1.409A-1(q). For additional rules relating to the application of this paragraph (b) to amounts payable at a fixed time or pursuant to a fixed schedule, see § 1.409A-3(i)(1).

\* \* \* \* \*

■ **Par. 5.** Section 1.409A-3 is amended by:

- 1. Revising paragraph (b).
- 2. Redesignating paragraph (d) as paragraph (d)(1) and revising the heading of paragraph (d)(1).
- 3. Adding paragraph (d)(2).
- 4. Revising paragraphs (i)(5)(iii) and (i)(5)(iv)(A).
- 5. Revising paragraphs (j)(1) and (j)(2).
- 6. Revising paragraph (j)(4)(iii)(B).
- 7. Revising paragraphs (j)(4)(ix)(A) and (j)(4)(ix)(C).
- 8. Revising paragraph (j)(4)(xiii).

The revisions and additions read as follows:

**§ 1.409A-3 Permissible payments.**

\* \* \* \* \*

(b) *Designation of payment upon a permissible payment event.* Except as otherwise specified in this section, a plan provides for the payment upon an event described in paragraph (a)(1), (2), (3), (5), or (6) of this section if the plan provides the date of the event is the payment date, or specifies another payment date that is objectively determinable and nondiscretionary at the time the event occurs. A plan may also provide that a payment upon an event described in paragraph (a)(1), (2), (3), (5), or (6) of this section is to be made in accordance with a schedule that is objectively determinable and nondiscretionary based on the date the event occurs and that would qualify as a fixed schedule under paragraph (i)(1) of this section if the payment event were instead a fixed date, provided that the schedule must be fixed at the time the permissible payment event is designated. In addition, a plan may provide that a payment, including a payment that is part of a schedule, is to be made during a designated taxable year of the service provider that is objectively determinable and nondiscretionary at the time the payment event occurs such as, for

example, a schedule of three substantially equal payments payable during the first three taxable years following the taxable year in which a separation from service occurs. A plan may also provide that a payment, including a payment that is part of a schedule, is to be made during a designated period objectively determinable and nondiscretionary at the time the payment event occurs, but only if the designated period both begins and ends within one taxable year of the service provider or the designated period is not more than 90 days and the service provider does not have a right to designate the taxable year of the payment (other than an election that complies with the subsequent deferral election rules of § 1.409A-2(b)).

However, in the case of a payment to be made following the death of the service provider or a beneficiary who has become entitled to payment due to the service provider's death, in addition to the permitted designated periods described in the previous sentence, the designated period may begin on the date of death and end on December 31 of the first calendar year following the calendar year during which the death occurs, and the payment recipient may have the right to designate the taxable year of payment. If a plan provides for a period of more than one day following a payment event during which a payment may be made, such as permitting payment within 90 days following the date of the event, the payment date for purposes of the subsequent deferral rules under § 1.409A-2(b) is treated as the first possible date upon which a payment could be made under the terms of the plan. A plan may provide for payment upon the earliest or latest of more than one event or time, provided that each event or time is described in paragraphs (a)(1) through (6) of this section. For examples illustrating the provisions of this paragraph, see paragraph (i)(1)(vi) of this section.

\* \* \* \* \*

(d) *When a payment is treated as made upon the designated payment date—(1) In general.* \* \* \*

(2) *Payments due following death.* A payment specified to be made under the plan on any date within the period beginning on the date of the death of the service provider, or of a beneficiary who has become entitled to payment due to the service provider's death, and ending on December 31 of the first calendar year following the calendar year during which the death occurs (including a payment specified to be made upon death) is treated as made on the date

specified under the plan if the payment is made on any date during this period, regardless of whether the payment recipient designates the taxable year of payment. Further, any change to the time or form of a payment that is specified to be made under the plan during this period to provide that the payment will be made on any other date during this period will not be treated as a subsequent deferral election for purposes of § 1.409A-2(b)(1) or an impermissible acceleration for purposes of § 1.409A-3(j)(1).

\* \* \* \* \*

- (i) \* \* \*
(5) \* \* \*

(iii) Attribution of stock ownership.

For purposes of paragraph (i)(5) of this section, section 318(a) applies to determine stock ownership. Stock underlying a vested option is considered owned by the person who holds the vested option (and the stock underlying a nonvested option is not considered owned by the person who holds the nonvested option). For purposes of the preceding sentence, however, if a vested option is exercisable for stock that is not substantially vested (as defined by § 1.83-3(b) and (j)), the stock underlying the option is not treated as owned by the person who holds the option.

\* \* \* \* \*

(iv) Special rules for certain delayed payments pursuant to a change in control event—(A) Certain transaction-based compensation. Payments of compensation related to a change in control event described in paragraph (i)(5)(v) of this section (change in the ownership of a corporation) or paragraph (i)(5)(vii) of this section (change in the ownership of a substantial portion of a corporation's assets) that occur because a service recipient purchases its stock held by the service provider or because the service recipient or a third party purchases a stock right or a statutory stock option described in § 1.409A-1(b)(5)(ii) held by a service provider, or that are calculated by reference to the value of stock of the service recipient (collectively, transaction-based compensation), may be treated as paid on a designated date or pursuant to a payment schedule that complies with the requirements of section 409A if the transaction-based compensation is paid on the same schedule and under the same terms and conditions as apply to payments to shareholders generally with respect to stock of the service recipient pursuant to a change in control event described in paragraph (i)(5)(v) of this section (change in the ownership of a

corporation) or as apply to payments to the service recipient pursuant to a change in control event described in paragraph (i)(5)(vii) of this section (change in the ownership of a substantial portion of a corporation's assets). In addition, to the extent that the transaction-based compensation is paid not later than five years after the change in control event, the payment of such compensation will not violate the initial or subsequent deferral election rules set out in § 1.409A-2(a) and (b) solely as a result of such transaction-based compensation being paid pursuant to such schedule and terms and conditions. The payment or agreement to pay transaction-based compensation payable with respect to a stock right described in § 1.409A-1(b)(5)(i)(A) or (B) or a statutory stock option described in § 1.409A-1(b)(5)(ii) also will not cause the stock right or statutory stock option to be treated as having provided for the deferral of compensation from the original grant date solely as a result of the transaction-based compensation being paid on the same schedule and under the same terms and conditions as apply to payments to shareholders generally with respect to stock of the service recipient pursuant to the change in control event described in paragraph (i)(5)(v) of this section (change in the ownership of a corporation) or as apply to payments to the service recipient pursuant to the change in control event described in paragraph (i)(5)(vii) of this section (change in the ownership of a corporation's assets) and the transaction-based compensation is paid not later than five years after the change in control event. If before and in connection with a change in control event described in paragraph (i)(5)(v) or (i)(5)(vii) of this section, transaction-based compensation that would otherwise be payable as a result of such event is made subject to a condition on payment that is a substantial risk of forfeiture (as defined in § 1.409A-1(d), without regard to the provisions of that section under which additions or extensions of forfeiture conditions are disregarded) and the transaction-based compensation is payable under the same terms and conditions as apply to payments made to shareholders generally with respect to stock of the service recipient pursuant to a change in control event described in paragraph (i)(5)(v) of this section or to payments to the service recipient pursuant to a change in control event described in paragraph (i)(5)(vii) of this section, for purposes of determining whether such transaction-based

compensation is a short-term deferral the requirements of § 1.409A-1(b)(4) are applied as if the legally binding right to such transaction-based compensation arose on the date that it became subject to such substantial risk of forfeiture.

\* \* \* \* \*

(j) Prohibition on acceleration of payments—(1) In general—Except as provided in paragraph (j)(4) of this section, a nonqualified deferred compensation plan may not permit the acceleration of the time or schedule of any payment or amount scheduled to be paid pursuant to the terms of the plan, and no such accelerated payment may be made whether or not provided for under the terms of such plan. For purposes of determining whether a payment of deferred compensation has been made, the rules of paragraph (f) of this section (on substituted payments) apply. For purposes of this paragraph (j), an impermissible acceleration does not occur if payment is made in accordance with plan provisions or an election as to the time and form of payment in effect at the time of initial deferral (or added in accordance with the rules applicable to subsequent deferral elections under § 1.409A-2(b)) pursuant to which payment is required to be made on an accelerated schedule as a result of an intervening payment event that is an event described in paragraph (a)(1), (2), (3), (5) or (6) of this section. For such purpose, the intervening payment event may apply with respect to either the service provider or, following the service provider's death, a beneficiary who becomes entitled to payment due to the service provider's death (substituting such beneficiary for the service provider in the definitions of disability in paragraph (i)(4) of this section and unforeseeable emergency in paragraph (i)(3) of this section, as applicable). For example, a plan may provide that a participant will receive six installment payments commencing at separation from service, and also provide that if the participant dies after such payments commence but before all payments have been made, all remaining amounts will be paid in a lump sum payment. Additionally, it is not an acceleration of the time or schedule of payment of a deferral of compensation if a service recipient waives or accelerates the satisfaction of a condition constituting a substantial risk of forfeiture applicable to such deferral of compensation, provided that the requirements of section 409A (including the requirement that the payment be made upon a permissible payment event) are otherwise satisfied with respect to such

deferral of compensation. For example, if a nonqualified deferred compensation plan provides for a lump sum payment of the vested benefit upon separation from service, and the benefit vests under the plan only after 10 years of service, it is not a violation of the requirements of section 409A if the service recipient reduces the vesting requirement to five years of service, even if a service provider becomes vested as a result and receives a payment in connection with a separation from service before the service provider would have completed 10 years of service. However, if the plan in this example had provided for a payment on a fixed date, rather than at separation from service, the date of payment could not be accelerated due to the accelerated vesting. For the definition of a payment for purposes of this paragraph (j), see § 1.409A-2(b)(5) (coordination of the subsequent deferral election rules with the prohibition on acceleration of payments). For other permissible payments, see § 1.409A-2(b)(2)(iii) (certain immediate payments of remaining installments) and paragraph (d) of this section (certain payments made no more than 30 days before the designated payment date).

(2) *Application to multiple payment events.* The addition of a permissible payment event, the deletion of a permissible payment event, or the substitution of one permissible payment event for another permissible payment event, results in an acceleration of a payment if the addition, deletion, or substitution could result in the payment being made on an earlier date than such payment would have been made absent such addition, deletion, or substitution. Notwithstanding the previous sentence, the addition of death, disability (as defined in paragraph (i)(4) of this section), or an unforeseeable emergency (as defined in paragraph (i)(3) of this section), as a potentially earlier alternative or intervening payment event to an amount previously deferred will not be treated as resulting in an acceleration of a payment, even if such addition results in the payment being paid at an earlier time than such payment would have been made absent the addition of the payment event. For such purpose, the earlier alternative or intervening payment event may apply with respect to either the service provider or, following the service provider's death, a beneficiary who becomes entitled to payment due to the service provider's death (substituting such beneficiary for the service provider in the definitions of *disability* in paragraph (i)(4) of this section and *unforeseeable emergency* in paragraph

(i)(3) of this section, as applicable). However, the addition of such a payment event as a potentially later alternative payment event generally is subject to the rules governing changes in the time and form of payment (see § 1.409A-2(b)).

\* \* \* \* \*

(4) \* \* \*

(iii) \* \* \*

(B) *Compliance with ethics laws or conflicts of interest laws.* A plan may provide for acceleration of the time or schedule of a payment under the plan, or a payment may be made under a plan, to the extent reasonably necessary to avoid the violation of an applicable Federal, state, local, or *bona fide* foreign ethics law or conflicts of interest law (including under circumstances in which such payment is reasonably necessary to permit the service provider to participate in activities in the normal course of his or her position in which the service provider would otherwise not be able to participate under an applicable rule). A payment is reasonably necessary to avoid the violation of a Federal, state, local, or *bona fide* foreign ethics law or conflicts of interest law if the payment is a necessary part of a course of action that results in compliance with a Federal, state, local, or *bona fide* foreign ethics law or conflicts of interest law that would be violated absent such course of action, regardless of whether other actions would also result in compliance with the Federal, state, local, or *bona fide* foreign ethics law or conflicts of interest law.

\* \* \* \* \*

(ix) \* \* \*

(A) The service recipient's termination and liquidation of the plan within 12 months of a corporate dissolution taxed under section 331, or with the approval of a U.S. bankruptcy court, provided that the amounts deferred under the plan are included in the participants' gross incomes in the latest of the following years (or, if earlier, the taxable year in which the amount is actually or constructively received).

(1) The calendar year in which the plan termination and liquidation occurs;

(2) The first calendar year in which the amount is no longer subject to a substantial risk of forfeiture; or

(3) The first calendar year in which the payment is administratively practicable.

\* \* \* \* \*

(C) The service recipient's termination and liquidation of the plan, provided that—

(1) The termination and liquidation does not occur proximate to a downturn

in the financial health of the service recipient;

(2) The service recipient terminates and liquidates all agreements, methods, programs, and other arrangements sponsored by the service recipient that would be aggregated with any terminated and liquidated agreements, methods, programs, and other arrangements under § 1.409A-1(c) as if there were one service provider that had deferrals of compensation under every such agreement, method, program, and other arrangement sponsored by the service recipient (for example, all elective account balance plans that the service recipient sponsors);

(3) No payments in liquidation of the plan are made within 12 months of the date the service recipient takes all necessary action to irrevocably terminate and liquidate the plan other than payments that would be payable under the terms of the plan if the action to terminate and liquidate the plan had not occurred;

(4) All payments are made within 24 months of the date the service recipient takes all necessary action to irrevocably terminate and liquidate the plan; and

(5) The service recipient does not adopt any new agreement, method, program, or other arrangement described in paragraph (C)(2) of this subsection, at any time within three years following the date the service recipient takes all necessary action to irrevocably terminate and liquidate the plan.

\* \* \* \* \*

(xiii) *Certain offsets*—(A) *De minimis offset.* A plan may provide for the acceleration of the time or schedule of a payment, or a payment may be made under such plan, as satisfaction of a debt of the service provider to the service recipient, if such debt is incurred in the ordinary course of the service relationship between the service recipient and the service provider, the entire amount of reduction in any of the service recipient's taxable years does not exceed \$5,000, and the reduction is made at the same time and in the same amount as the debt otherwise would have been due and collected from the service provider.

(B) *Compliance with Federal debt collection laws.* A plan may provide for the acceleration of the time or schedule of a payment, or a payment may be made under such plan, as satisfaction of a debt of the service provider to the service recipient, to the extent reasonably necessary to comply with 31 U.S.C. 3711 et. seq. or similar Federal nontax law regarding debt collection relating to claims of the Federal

government. A payment is reasonably necessary to comply with such a Federal debt collection law if the payment is a necessary part of a course of action that results in compliance with the Federal debt collection law that would be violated absent such course of action, regardless of whether other actions would also result in compliance with the Federal debt collection law.

\* \* \* \* \*

■ **Par. 6.** Section 1.409A-4 (REG-148326-05), as proposed at 73 FR 74380 (December 8, 2008), is proposed to be amended by revising paragraph (a)(1)(ii)(B) to read as follows:

**§ 1.409A-4 Calculation of amount includible in income and additional income taxes.**

\* \* \* \* \*

(B) *Treatment of certain deferred amounts otherwise subject to a substantial risk of forfeiture—(1) Risk of forfeiture disregarded.* For purposes of determining the amount includible in income under section 409A(a)(1) and paragraph (a)(1)(i) of this section, an amount deferred under a plan that is otherwise subject to a substantial risk of forfeiture for a taxable year is treated as not subject to a substantial risk of forfeiture for the taxable year, if during the taxable year any of the following occur:

(i) A change (including an initial deferral election) that is not authorized under § 1.409A-1, § 1.409A-2, or § 1.409A-3 is made to a provision of the plan providing for the time or form of payment of the deferred amount, if the service recipient has not made a reasonable, good faith determination that, absent the change, the provision fails to comply with the requirements of section 409A(a).

(ii) The service recipient has engaged in a pattern or practice of permitting substantially similar failures to comply with section 409A(a) under one or more nonqualified deferred compensation plans while amounts deferred under the plans are nonvested, and the facts and circumstances indicate that the deferred amount would be affected by the pattern or practice. Whether such a pattern or practice exists will depend on the facts and circumstances, including, but not limited to, whether the service recipient has taken commercially reasonable measures to identify and correct the substantially similar failures promptly upon discovery, whether the failures have affected nonvested deferred amounts with greater frequency than vested deferred amounts, whether the failures have occurred more frequently under newly adopted plans, and whether the failures appear intentional,

are numerous, or repeat one or more similar past failures that were previously identified and corrected.

(iii) The correction of a failure to comply with section 409A(a) affecting the deferred amount is not consistent with an applicable correction method (if one exists) set forth in applicable guidance issued by the Treasury Department and the IRS for correcting failures under section 409A(a), or the failure is not corrected in substantially the same manner as a substantially similar failure affecting a nonvested deferred amount under another plan sponsored by the service recipient. Solely with respect to the deferred amount, the requirements under applicable correction guidance with respect to eligibility, income inclusion, additional taxes, premium interest, and information reporting by the service recipient or service provider do not apply.

■ **Par. 7.** Section 1.409A-6 is amended by revising paragraph (b) to read as follows:

**§ 1.409A-6 Application of section 409A and effective dates.**

\* \* \* \* \*

(b) *Regulatory applicability date.* Section 1.409A-0, § 1.409A-1, § 1.409A-2, § 1.409A-3 and this section, as amended, apply for taxable years beginning on or after publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**. Section 1.409A-0, § 1.409A-1, § 1.409A-2, § 1.409A-3 and this section as they appeared in the April 2009 edition of 26 CFR part 1 apply for taxable years beginning on or after January 1, 2009 and before publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**.

**John M. Dalrymple,**

*Deputy Commissioner for Services and Enforcement.*

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**DEPARTMENT OF THE TREASURY**

**Alcohol and Tobacco Tax and Trade Bureau**

**27 CFR Parts 4 and 24**

[Docket No. TTB-2016-0005; Notice No. 160]

RIN 1513-AC27

**Proposed Revisions to Wine Labeling and Recordkeeping Requirements**

**AGENCY:** Alcohol and Tobacco Tax and Trade Bureau, Treasury.

**ACTION:** Notice of proposed rulemaking.

**SUMMARY:** The Alcohol and Tobacco Tax and Trade Bureau (TTB) proposes to amend its labeling and recordkeeping regulations in 27 CFR part 24 to provide that any standard grape wine containing 7 percent or more alcohol by volume that is covered by a certificate of exemption from label approval may not be labeled with a varietal (grape type) designation, a type designation of varietal significance, a vintage date, or an appellation of origin unless the wine is labeled in compliance with the standards set forth in the appropriate sections of 27 CFR part 4 for that label information. TTB is also proposing to amend its part 4 wine labeling regulations to include a reference to the new part 24 requirement.

**DATES:** TTB must receive written comments on or before August 22, 2016.

**ADDRESSES:** Please send your comments on this document to one of the following addresses:

- *Internet:* <http://www.regulations.gov> (via the online comment form for this notice as posted within Docket No. TTB-2016-0005 at “*Regulations.gov*,” the Federal e-rulemaking portal);

- *U.S. Mail:* Director, Regulations and Rulings Division, Alcohol and Tobacco Tax and Trade Bureau, 1310 G Street NW., Box 12, Washington, DC 20005; or

- *Hand delivery/courier in lieu of mail:* Alcohol and Tobacco Tax and Trade Bureau, 1310 G Street NW., Suite 400, Washington, DC 20005.

See the Public Participation section of this notice for specific instructions and requirements for submitting comments, and for information on how to request a public hearing.

You may view copies of this document and any comments TTB receives about this proposal at <http://www.regulations.gov> within Docket No. TTB-2016-0005. A link to that docket is posted on the TTB Web site at <http://www.ttb.gov/wine/wine-rulemaking.shtml> under Notice No. 160. You also may view copies of this