Bulletin No. 1996–12
March 18, 1996

HIGHLIGHTS OF THIS ISSUE

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

INCOME TAX

T.D. 8653, page 4.
Final regulations under sections 446 and 1221 of the Code relate to the character and timing of gain or loss from certain hedging transactions entered into by members of a consolidated group.

T.D. 8655, page 9.
Final and temporary regulations under section 7805 of the Code are declared obsolete as part of the President's Regulatory Reinvention Initiative.

EMPLOYMENT TAX

EE–55–95, page 12.
Proposed regulations under section 3306(r) of the Code relate to when amounts deferred or paid from certain nonqualified deferred compensation plans are taken into account as ''wages'' for FUTA purposes.

EE–142–87, page 13.
Proposed regulations under section 3121(v)(2) of the Code relate to when amounts deferred or paid from certain nonqualified deferred compensation plans are taken into account as ''wages'' for FICA purposes.

ADMINISTRATIVE

Notice 96–14, page 11.
T.D. 8650, 1996–10 I.R.B. 5, relating to the disallowance of deductions for employee remuneration in excess of $1,000,000, is corrected.

Announcement 96–13, page 33.
Test of Employment Tax Early Referral Procedures for Appeals. This announcement describes the method by which a taxpayer requests early referral of one or more unagreed employment tax issues from the District to Appeals.

Announcement 96–14, page 35.
A list is given of organizations now classified as private foundations.

Finding Lists begin on page 39.

Mission of the Service

The purpose of the Internal Revenue Service is to collect the proper amount of tax revenue at the least cost; serve the public by continually improving the quality of our products and services; and perform in a manner warranting the highest degree of public confidence in our integrity, efficiency and fairness.

Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he or she is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

Introduction

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

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

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

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

The Bulletin is divided into four parts as follows:

Part I.—1986 Code.

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

Part II.—Treaties and Tax Legislation.

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

Part III.—Administrative, Procedural, and Miscellanous.

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

Part IV.—Items of General Interest.

With the exception of the Notice of Proposed Rulemaking and the disbarment and suspension list included in this part, none of these announcements are consolidated in the Cumulative Bulletins.

The first Bulletin for each month includes an index for the matters published during the preceding month. These monthly indexes are cumulated on a quarterly and semiannual basis, and are published in the first Bulletin of the succeeding quarterly and semi-annual period, respectively.

The Bulletin Index-Digest System, a research and reference service supplementing the Bulletin, may be obtained from the Superintendent of Documents on a subscription basis. It consists of four Services: Service No. 1, Income Tax; Service No. 2, Estate and Gift Taxes; Service No. 3, Employment Taxes; Service No. 4, Excise Taxes. Each Service consists of a basic volume and a cumulative supplement that provides (1) finding lists of items published in the Bulletin, (2) digests of revenue rulings, revenue procedures, and other published items, and (3) indexes of Public Laws, Treasury Decisions, and Tax Conventions.

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

Section 446.—General Rule for Methods of Accounting

26 CFR 1.446–4: Hedging transactions

T.D. 8653

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 1 and 602

Hedging Transactions by Members of a Consolidated Group

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the character and timing of gain or loss from certain hedging transactions entered into by members of a consolidated group. These regulations apply when one member of the group hedges its own risk, hedges the risk of another member, or enters into a risk-shifting transaction with another member. The regulations are needed to provide appropriate rules for these transactions. The regulations provide guidance for corporations that are members of consolidated groups.

DATES: These regulations are effective February 7, 1996.

For dates of applicability of these regulations, see §1.446–4(e)(9)(iv) and §1.1221–2(g)(4), (5), and (6).

FOR FURTHER INFORMATION CONTACT: Jo Lynn Ricks of the Office of the Assistant Chief Counsel (Financial Institutions and Products), telephone (202) 622-3920 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information contained in these final regulations have been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545–1480. Some responses to these collections of information are mandatory, and others are required to obtain the benefit of the separate-entity election or of applying single-entity treatment in taxable years prior to the general effective date of the regulations.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid control number.

The estimated annual burden per respondent or recordkeeper varies from 1.0 to 40.0 hours, depending on individual circumstances, with an estimated average of 5 hours.

Comments concerning the accuracy of this burden estimate and suggestions for reducing this burden should be sent to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, T:FP, Washington, DC 20224, and to the Office of Management and Budget, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503.

Books or records relating to this collection of information must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

On July 18, 1994, the IRS published in the Federal Register (59 FR 36394) a notice of proposed rulemaking (FI–34–94 [1994–2 C.B. 863]) relating to the character and timing of gain or loss from certain risk-shifting transactions entered into by members of a consolidated group. Comments were received on the proposed regulations, and a public hearing was held on October 18, 1994. Most commentators believe that the proposed regulations provide a sensible and flexible set of rules to deal with hedging operations by the members of a consolidated group of corporations.

The most significant comment on the regulations relates to their effective date. Almost all of the commentators requested a transition rule permitting consolidated groups to elect to apply the proposed character rules retroactively. The final regulations adopt this suggestion, generally allowing consolidated groups to elect to apply the single-entity approach of the proposed regulations to all open years. Section 1.1221–2, concerning the character of hedging transactions, was made retroactive for all open years to permit the IRS to resolve fairly and consistently controversies involving transactions that were entered into prior to the publication date of those regulations. It is appropriate that these regulations, as an integral part of §1.1221–2, also apply retroactively. To prevent any adverse consequences, however, retroactivity is elective.

The proposed regulations, with new effective date provisions, are adopted as final regulations. The new provisions, and several comments that were not adopted, are discussed below.

Explanation of provisions

Character regulations

The final regulations retain the single-entity approach of the proposed regulations. That is, they treat the risk of one member of the group as the risk of the other members, as if all the members were divisions of a single corporation. Thus, a member of a consolidated group that hedges the risk of another member by entering into a transaction with a third party may receive ordinary gain or loss treatment on that transaction if the transaction otherwise qualifies as a hedging transaction.

Under this single-entity approach, intercompany transactions are neither hedging transactions nor hedged items. Because they are treated as transactions between divisions of a single corporation, intercompany transactions do not reduce the risk of that single corporation and, therefore, fail to qualify as hedging transactions.

Some commentators requested that the IRS extend the single-entity approach to apply the hedging rules to a taxpayer's transactions that hedge the risk of a related party that is not a member of the taxpayer's consolidated group. The IRS and Treasury, however, do not believe that this approach is appropriate where the parties file dif-

ferent tax returns. Accordingly, the final regulations do not adopt this suggestion.

The final regulations also retain the separate-entity election of the proposed regulations, permitting a consolidated group to treat its members as separate entities when applying the hedging rules. The election is made by attaching a statement to the group's federal income tax return.

For a group that elects separate-entity treatment, an intercompany transaction is treated as a hedging transaction if and only if: (1) it would qualify as a hedging transaction if entered into with an unrelated party; and (2) it is entered into with a member that, under its method of accounting, marks its position in the intercompany transaction to market. If these requirements are satisfied, the member with respect to which it is an intercompany hedging transaction must account for its position in the transaction under §1.446–4, and, if that member properly identifies the transaction as a hedging transaction, each member treats the gain or loss from its position in the transaction as ordinary.

In response to comments, the final regulations clarify that, even when these two requirements are met, these regulations supplant only the character and timing rules of §1.1502–13. Other aspects of the transaction, such as the source of the gain or loss, are unaffected by these regulations and thus may be governed by §1.1502–13.

As noted above, commentators pointed out that taxpayers frequently enter into transactions to transfer their business risk to related parties that do not qualify as members of a consolidated group. Some commentators argued that, even if risk reduction in these circumstances is not analyzed using a single-entity perspective, the relationship between the parties to the risk transfer justifies a rule under which the party receiving the risk has ordinary gain or loss on its position in the transaction. That is, they wanted to apply one part of the separate-entity rules to taxpayers that are not part of the same consolidated group.

The IRS and Treasury, however, do not believe that additional, special character rules are appropriate for risk-shifting transactions outside the context of a consolidated group. Accordingly, the final regulations do not adopt these comments.

The final regulations expand upon the effective date provision of the proposed regulations. The final regulations generally apply to transactions entered into on or after March 8, 1996.

In response to comments, the final regulations permit a consolidated group to apply the single-entity approach of the regulations retroactively. The group may elect to begin to apply the single-entity approach for all transactions entered into in any taxable year (the election year) beginning prior to March 8, 1996. The election may be made, however, only if the election year and each subsequent taxable year are still open for assessment under section 6501 on July 1, 1996, or such earlier date as the Commissioner may allow. Once made, the single-entity election applies to all transactions entered into in the election year and in all subsequent consolidated return years until the date as of which the group makes a separate-entity election. The Service will publish guidance on the manner, and the time, for making the single-entity election.

Further, the regulations also permit a consolidated group to apply the separate-entity approach to all transactions entered into in taxable years subject to the election. The taxpayer may choose, as the first year under the election, any taxable year beginning on or after July 12, 1995. This ability to apply the election to taxable years beginning before March 8, 1996, allows a consolidated group to apply the separate-entity approach to all intercompany transactions that are subject to new §1.1502–13 (which is effective for taxable years beginning on or after July 12, 1995). Thus, by electing separate-entity treatment for all transactions entered into in a taxable year beginning on or after July 12, 1995, a consolidated group can determine the character and timing of its intercompany hedging transactions under §1.446–4 and §1.1221–2, rather than under §1.1502–13.

If the group makes the single-entity election or elects to apply the separate-entity approach retroactively, special identification rules apply.

First, the members of the group are required to identify transactions that were entered into prior to March 8, 1996, that are still in existence on that date, and that become hedging transactions as a result of one of these elections. The members are also required to identify the hedged item for these transactions.

Second, the final regulations extend the time period for making the additional identifications that are referred to in the preceding paragraph.

Third, if the taxpayer's consolidated group has elected the single-entity approach, the regulations nullify all hedge identifications under §1.1221–2-(e)(i) that had been made for intercompany transactions. In this situation, the regulations determine the character of each intercompany transaction as if it had never been identified as a hedging transaction. Thus, the character and timing of the intercompany transaction are determined under the otherwise applicable regulations, and the transaction is not subject to the ordinary-gain, capital-loss rule that generally applies to transactions that are incorrectly identified as hedging transactions. The identification may, however, serve to identify the hedged item.

In order to ensure that consolidated groups do not improperly use hindsight in making these identifications, the regulations provide a consistency requirement. Under this requirement, the group members must treat similar or identical transactions consistently within the same year and from year to year. If a member of the consolidated group fails to identify a hedging transaction as a hedging transaction, but has identified similar or identical hedging transactions in the same or a subsequent year, then, for purposes of §1.1221–2(f)(2)(iii), the member entering into the transaction is treated as having no reasonable grounds for treating the transaction as other than a hedging transaction. Thus, the member is generally subject to the ordinary-gain, capital-loss rules for taxpayers who fail to identify transactions as hedging transactions.

Timing regulations

The final regulations clarify the general rule that was provided in the proposed regulations for the timing of the gain or loss from hedging transactions that are entered into by members of a consolidated group. Under the final regulations, a member of a consolidated group must account for its hedging transactions as if all the members were separate divisions of a single corporation (the single-entity approach). Thus, the timing of the

income, deduction, gain, or loss on the hedging transaction must match the timing of the income, deduction, gain, or loss from the item, items, or aggregate risk being hedged. These regulations make clear that a member must account for all of its hedging transactions, not just those that hedge the risk of another member, under the single-entity approach.

Since all of the members are treated as divisions of a single corporation, intercompany transactions are neither hedging transactions nor hedged items. Thus, under the single-entity approach, the timing of the gain or loss from intercompany transactions is not determined under the rules of §1.446–4.

The final regulations also clarify the rule in the proposed regulations on accounting for the gain or loss on hedging transactions by members of a group that has made a separate-entity election. If a group makes the separate-entity election, the members do not account for their hedging transactions (including their intercompany hedging transactions) as if they were divisions of a single corporation. Rather, each member accounts for its hedging transactions on a member-by-member basis. For example, if an intercompany transaction is treated as a hedging transaction, the gain or loss on the transaction is accounted for under the rules of §1.446–4 rather than under the timing rules of the intercompany transaction regulations, §1.1503–13. As was stated above, even when a separate-entity election is in place, §§1.1221–2 and 1.446–4 affect only the timing and character of intercompany hedging transactions. Other aspects of the intercompany hedging transaction remain subject to the rules of §1.1502–13.

These final timing regulations are effective for transactions entered into on or after March 8, 1996.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It is hereby certified that these regulations do not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that these regulations will primarily affect affiliated groups of corporations that have elected to file consolidated returns, which tend to be larger businesses. The regulations do not significantly alter the reporting or recordkeeping duties of small entities. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations was submitted to the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Jo Lynn Ricks, Office of Assistant Chief Counsel (Financial Institutions and Products), IRS. However, other personnel from the IRS and Treasury Department participated in their development.

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Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 602 are amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by removing the entry for §1.1221–2 and by adding entries in numerical order to read as follows:

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

Section 1.446–4 also issued under 26 U.S.C. 1502. * * *

Section 1.1221–2 also issued under 26 U.S.C. 1502 and 6001. * * *

Par. 2. Section 1.446–4 is amended by adding the text of paragraph (e)(9) to read as follows:

§1.446–4 Hedging Transactions.

* * * * * *

(e) * * *

(9) *Hedging by members of a consolidated group*—(i) *General rule: single-entity approach.* In general, a member of a consolidated group must account for its hedging transactions as if all of the members were separate divisions of a single corporation. Thus, the timing of the income, deduction, gain, or loss on a hedging transaction must match the timing of income, deduction, gain, or loss from the item or items being hedged. Because all of the members are treated as if they were divisions of a single corporation, intercompany transactions are neither hedging transactions nor hedged items for these purposes.

(ii) *Separate-entity election.* If a consolidated group makes an election under §1.1221–2(d)(2), then paragraph (e)(9)(i) of this section does not apply. Thus, in that case, each member of the consolidated group must account for its hedging transactions in a manner that meets the requirements of paragraph (b) of this section. For example, the income, deduction, gain, or loss from intercompany hedging transactions (as defined in §1.1221–2(d)(2)(ii)) is taken into account under the timing rules of §1.446–4 rather than under the timing rules of §1.1502–13.

(iii) *Definitions.* For definitions of consolidated group, divisions of a single corporation, intercompany transaction, and member, see section 1502 and the regulations thereunder.

(iv) *Effective date.* This paragraph (e)(9) applies to transactions entered into on or after March 8, 1996.

Par. 3. Section 1.1221–2 is amended by adding the text of paragraphs (d), (e)(5), (f)(3), and (g)(4), and by adding the text and headings of paragraphs (g)(5) and (6) to read as follows:

§1.1221–2 Hedging Transactions.

* * * * * *

(d) *Hedging by members of a consolidated group*—(1) *General rule: single-entity approach.* For purposes of this section, the risk of one member of a consolidated group is treated as the risk of the other members as if all of the members of the group were divisions of a single corporation. For example, if any member of a consolidated group hedges the risk of another member of the group by entering into a transaction with a third party, that transaction may potentially qualify as a hedging transaction. Conversely, intercompany transactions are not hedging transactions because, when considered as transactions between divisions of a single corporation, they do not reduce the risk of that single corporation.

(2) *Separate-entity election.* In lieu of the single-entity approach specified

in paragraph (d)(1) of this section, a consolidated group may elect separate-entity treatment of its hedging transactions. If a group makes this separate-entity election, the following rules apply.

(i) *Risk of one member not risk of other members*. Notwithstanding paragraph (d)(1) of this section, the risk of one member is not treated as the risk of other members.

(ii) *Intercompany transactions*. An intercompany transaction is a hedging transaction (an intercompany hedging transaction) with respect to a member of a consolidated group if and only if it meets the following requirements—

(A) The position of the member in the intercompany transaction would qualify as a hedging transaction with respect to the member (taking into account paragraph (d)(2)(i) of this section) if the member had entered into the transaction with an unrelated party; and

(B) The position of the other member (the marking member) in the transaction is marked to market under the marking member's method of accounting.

(iii) *Treatment of intercompany hedging transactions*. An intercompany hedging transaction (that is, a transaction that meets the requirements of paragraphs (d)(2)(ii)(A) and (B) of this section) is subject to the following rules—

(A) The character and timing rules of §1.1502–13 do not apply to the income, deduction, gain, or loss from the intercompany hedging transaction; and

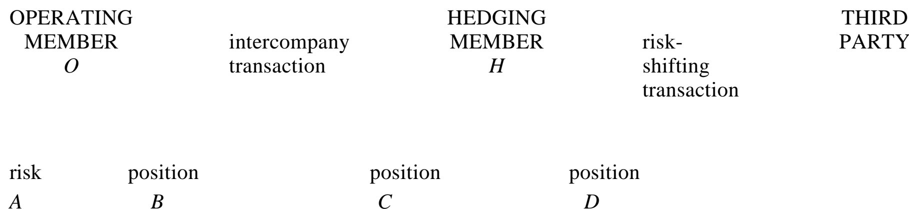
(B) Except as provided in paragraph (f)(3) of this section, the character of the marking member's gain or loss from the transaction is ordinary.

(iv) *Making and revoking the election*. Unless the Commissioner otherwise prescribes, the election described in this paragraph (d)(2) must be made in a separate statement saying ''[Insert Name and Employer Identification Number of Common Parent] HEREBY ELECTS THE APPLICATION OF SECTION 1.1221–2(d)(2) (THE SEPARATE-ENTITY APPROACH).'' The statement must also indicate the date as of which the election is to be effective. The election must be signed by the common parent and filed with the group's federal income tax return for the taxable year that includes the first date for which the election is to apply. The election applies to all transactions entered into on or after the date so indicated.

(3) *Definitions*. For definitions of consolidated group, divisions of a single corporation, group, intercompany transactions, and member, see section 1502 and the regulations thereunder.

(4) *Examples*. The following examples illustrate this paragraph (d):

General Facts. In these examples, *O* and *H* are members of the same consolidated group. *O*'s business operations give rise to interest rate risk ''*A*,'' which *O* wishes to hedge. *O* enters into an intercompany transaction with *H* that transfers the risk to *H*. *O*'s position in the intercompany transaction is ''*B*,'' and *H*'s position in the transaction is ''*C*.'' *H* enters into position ''*D*'' with a third party to reduce the interest rate risk it has with respect to its position *C*. *D* would be a hedging transaction with respect to risk *A* if *O*'s risk *A* were *H*'s risk.



Example 1. Single-entity treatment—(i) *General rule*. Under paragraph (d)(1) of this section, *O*'s risk *A* is treated as *H*'s risk, and therefore *D* is a hedging transaction with respect to risk *A*. Thus, the character of *D* is determined under the rules of this section, and the income, deduction, gain, or loss from *D* must be accounted for under a method of accounting that satisfies §1.446–4. The intercompany transaction *B–C* is not a hedging transaction and is taken into account under §1.1502–13.

(ii) *Identification*. *D* must be identified as a hedging transaction under paragraph (e)(1) of this section, and *A* must be identified as the hedged item under paragraph (e)(2) of this section. Under paragraph (e)(5) of this section, the identification of *A* as the hedged item can be accomplished by identifying the positions in the intercompany transaction as hedges or hedged items, as appropriate. Thus, substantially contemporaneous with entering into *D*, *H* may identify *C* as the hedged item and *O* may identify *B* as a hedge and *A* as the hedged item.

Example 2. Separate-entity election; counterparty that does not mark to market. In addition to the *General Facts* stated above, assume that the group makes a separate-entity election under paragraph (d)(2) of this section. If *H* does not mark *C* to market under its method of accounting, then *B* is not a hedging transaction, and the *B–C* intercompany transaction is taken into account under the rules of section 1502. *D* is not a hedging transaction with respect to *A*, but *D* may be a hedging transaction with respect to *C* if *C* is ordinary property or an ordinary obligation and if the other requirements of paragraph (b) of this section are met. If *D* is not part of a hedging transaction, then *D* may be part of a straddle for purposes of section 1092.

Example 3. Separate-entity election; counterparty that marks to market. The facts are the same as in *Example 2* above, except that *H* marks *C* to market under its method of accounting. Also assume that *B* would be a hedging transaction with respect to risk *A* if *O* had entered into that transaction with an unrelated party. Thus, for *O*, the *B–C* transaction is an intercompany hedging transaction with respect to *O*'s risk *A*, the character and timing rules of §1.1502–13 do not apply to the *B–C* transaction, and *H*'s income, deduction, gain, or loss from *C* is ordinary. However, other attributes of the items from the *B–C* transaction are determined under §1.1502–13. *D* is a hedging transaction with respect to *C* if it meets the requirements of paragraph (b) of this section.

(e) * * *

(5) *Identification of hedges involving members of a consolidated group*—(i) *General rule: single-entity approach*. A member of a consolidated group must satisfy the requirements of this paragraph (e) as if all of the members of the group were divisions of a single corporation. Thus, the member entering into the hedging transaction with a third party must identify the hedging transaction under paragraph (e)(1) of this section. Under paragraph (e)(2) of this section, that member must also identify the item, items, or aggregate risk that is being hedged, even if the

item, items, or aggregate risk relates primarily or entirely to other members of the group. If the members of a group use intercompany transactions to transfer risk within the group, the requirements of paragraph (e)(2) of this section may be met by identifying the intercompany transactions, and the risks hedged by the intercompany transactions, as hedges or hedged items, as appropriate. Because identification of the intercompany transaction as a hedge serves solely to identify the hedged item, the identification is timely if made within the period required by paragraph (e)(2) of this section. For example, if a member transfers risk in an intercompany transaction, it may identify under the rules of this paragraph (e) both its position in that transaction and the item, items, or aggregate risk being hedged. The member that hedges the risk outside the group may identify under the rules of this paragraph (e) both its position with the third party and its position in the intercompany transaction. Paragraph (d)(4) *Example 1* of this section illustrates this identification.

(ii) *Rule for consolidated groups making the separate-entity election*. If a consolidated group makes the separate-entity election under paragraph (d)(2) of this section, each member of the group must satisfy the requirements of this paragraph (e) as though it were not a member of a consolidated group.

* * * * * *

(f) * * *

(3) *Transactions by members of a consolidated group*—(i) *Single-entity approach*. If a consolidated group is under the general rule of paragraph (d)(1) of this section (the single-entity approach), the rules of this paragraph (f) apply only to transactions that are not intercompany transactions.

(ii) *Separate-entity election*. If a consolidated group has made the election under paragraph (d)(2) of this section, then, in addition to the rules of paragraphs (f)(1) and (2) of this section, the following rules apply.

(A) If an intercompany transaction is identified as a hedging transaction but does not meet the requirements of paragraphs (d)(2)(ii)(A) and (B) of this section, then, notwithstanding any contrary provision in §1.1502–13, each party to the transaction is subject to the rules of paragraph (f)(1) of this section with respect to the transaction as though it had incorrectly identified its position in the transaction as a hedging transaction.

(B) If a transaction meets the requirements of paragraphs (d)(2)(ii)(A) and (B) of this section but the transaction is not identified as a hedging transaction, each party to the transaction is subject to the rules of paragraph (f)(2) of this section. (Because the transaction is an intercompany hedging transaction, the character and timing rules of §1.1502–13 do not apply. See paragraph (d)(2)(iii)(A) of this section.)

(g) * * *

(4) *Effective date and transition rules for hedges by members of a consolidated group*. Paragraphs (d), (e)(5), and (f)(3) of this section apply to transactions entered into on or after March 8, 1996.

(5) *Elections to accelerate the effective date of the regulations*—(i) *Election to apply the single-entity approach retroactively*. A consolidated group may elect to begin to apply paragraphs (d)(1) and (3), (e)(5)(i), and (f)(3)(i) of this section to all transactions entered into in any taxable year (the election year) beginning prior to March 8, 1996. This election must be made in the manner, and at the time, prescribed by the Commissioner. A group may make the election only if the election year, and each subsequent taxable year, are still open for assessment under section 6501 on July 1, 1996 (or such earlier date as the Commissioner may allow). The election applies to all transactions entered into in the election year and in all subsequent consolidated return years until the date, if any, as of which the group makes a separate-entity election under paragraph (d)(2) of this section. The rules of paragraph (g)(6) of this section apply to all transactions that were entered into before March 8, 1996, in taxable years subject to an election under this paragraph (g)(5)(i). The election may be revoked only with the consent of the Commissioner.

(ii) *Ability to apply the separate-entity approach retroactively*. Notwithstanding paragraph (g)(4) of this section, the separate-entity election described in paragraph (d)(2) of this section may be made for any taxable year beginning on or after July 12, 1995. If that election is made for a taxable year beginning before March 8, 1996, then paragraphs (d)(2) and (3), (e)(5)(ii), and (f)(3)(ii) of this section apply to all transactions entered into on or after the beginning of that taxable year and while the election is in effect, and the rules of paragraph (g)(6) of this section (other than paragraph (g)(6)(i)) apply to all transactions that were entered into on or after the first day of the first year for which the election is made and before March 8, 1996.

(6) *Transitional identification rules*. To allow a consolidated group to conform to paragraphs (g)(5)(i) and (ii) of this section, this paragraph (g)(6) nullifies certain hedge identifications and permits a member of a consolidated group to add certain hedge identifications. This paragraph (g)(6) applies only to the extent provided in paragraph (g)(5) of this section.

(i) *Intercompany transactions previously identified*. Notwithstanding paragraph (f)(1)(i) of this section, if, for purposes of paragraph (e)(1) of this section, a member identified as a hedging transaction an intercompany transaction (or a transaction that would qualify as an intercompany transaction under §1.1502–13(b)(1) if the taxable year in which the transaction was entered into were described in §1.1502–13(l)), the character of the gain on the intercompany transaction is determined as if it had not been identified as a hedging transaction. The identification may, however, serve to identify the hedged item under paragraph (e)(5)(i) of this section.

(ii) *Additional identifications of hedging transactions*. A member of a consolidated group must identify under paragraph (e)(5) of this section a transaction that—

(A) Was entered into before March 8, 1996,

(B) When entered into was not a hedging transaction (as defined in paragraph (b) of this section),

(C) Solely as a result of the group's election under paragraph (g)(5)(i) or (ii) of this section, is a hedging transaction (as defined in paragraph (b) of this section), and

(D) Remains in existence on March 8, 1996.

(iii) *Additional identification of hedged items*. In the case of transactions described in paragraph (g)(6)(ii) of this section, the hedging member must identify under paragraph (e)(5) of

this section the item, items, or aggregate risk being hedged.

(iv) *Consistency requirement for hedge identifications*. In identifying transactions as hedging transactions under paragraph (g)(6)(ii) of this section, all of the members of the group must treat similar or identical transactions consistently within the same year and from year to year. If paragraph (g)(6)(ii) of this section requires a member to identify a transaction, and the member fails to identify a transaction as a hedging transaction, but it or another member of the group identifies similar or identical hedging transactions in the same or a subsequent year, then for purposes of paragraphs (f)(2)(iii) and (3) of this section, the member entering into the transaction is treated as having no reasonable grounds for treating the transaction as other than a hedging transaction.

(v) *Extension of time for making additional identifications*. If an identification of a hedging transaction would not be required but for the rules of paragraph (g)(6)(ii) of this section, the identification is timely for purposes of paragraph (e)(1) of this section if made before the close of business on May 8, 1996. If an identification of a hedged item would not be required but for the rules of paragraph (g)(6)(iii) of this section, it is timely for purposes of paragraph (e)(2) of this section if made before the close of business on the later of May 8, 1996, or the last day of the period specified in paragraph (e)(2)(ii) of this section.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 4. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 5. In §602.101, paragraph (c) is amended by adding entries in numerical order to the table to read as follows:

§602.101 OMB Control numbers.

* * * * * *

(c) * * *

CFR part or section where identified and described	Current OMB control number
* * * * * *	
1.1221–2(d)(2)(iv)	1545–1480
1.1221–2(e)(5)	1545–1480
1.1221–2(g)(5)(ii)	1545–1480
1.1221–2(g)(6)(ii)	1545–1480
1.1221–2(g)(6)(iii)	1545–1480
* * * * * *	

Margaret Milner Richardson,
Commissioner of Internal Revenue.

Approved December 20, 1995.

Cynthia G. Beerbower,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on January 5, 1996, 8:45 a.m., and published in the issue of the Federal Register for January 8, 1996, 61 F.R. 517)

Section 7121.—Closing agreements

26 CFR 301.7121–1: Closing agreements.

What is the method by which a taxpayer requests early referral of one or more unagreed employment tax issues from the District to Appeals? *See* Announcement 96–13, page 33.

Section 7805.—Rules and Regulations

26 CFR 301.7805–1: Rules and regulations.

T.D. 8655

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 1, 20, 23, 24, 25, 27, 33, 38, 301, and 602

Removal of Final and Temporary Regulations

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Removal of final and temporary regulations.

SUMMARY: This document removes final and temporary regulations as part of the President's Regulatory Reinvention Initiative.

EFFECTIVE DATE: January 8, 1996.

FOR FURTHER INFORMATION CONTACT: Philip Bennet, (202) 622–3926.

SUPPLEMENTARY INFORMATION:

Background

As part of the President's Regulatory Reinvention Initiative, the Treasury Department and the IRS identified obsolete regulations that relate to prior law, provide elections for prior years, or are otherwise outdated due to changes in the underlying statutory provisions.

* * * * * *

Amendments to the Regulations

Accordingly, under the authority of 26 U.S.C. 7805, 26 CFR parts 1, 20, 23, 24, 25, 27, 33, 38, 301, and 602 are amended as follows:

PART 1—INCOME TAXES

Paragraph 1. Part 1 is amended as follows:

1. The authority citation for part 1 is amended by removing the entry for §1.1303–1.

2. Section 1.32–1 is removed.

3. Section 1.103–12 is removed.

4. Section 1.110–1 is removed.

5. Section 1.114–1 is removed.

6. Section 1.115–1 is removed.

7. Section 1.116–1 is removed.

8. Section 1.116–2 is removed.

9–10. Section 1.367(a)–7T is removed.

11. The undesignated center heading preceding §1.383–1A is removed.

12. Section 1.383–1A is removed.

13. Section 1.383–2A is removed.

14–15. Section 1.383–3A is removed.

16. Section 1.804–1 is removed.

17–18. Section 1.804–2 is removed.

19. Section 1.805–1 is removed.

20. Section 1.805–2 is removed.

21. Section 1.805–3 is removed.

22. Section 1.805–4 is removed.

23. Section 1.805–5 is removed.

24. Section 1.805–6 is removed.
25–26. Section 1.805–7 is removed.
27. Section 1.805–8 is removed.
28. Section 1.820–1 is removed.
29. Section 1.820–2 is removed.
30. Section 1.820–3 is removed.
31. Section 1.824–1 is removed.
32. Section 1.824–2 is removed.
33. Section 1.824–3 is removed.
34. Section 1.907–0 is amended as follows:

a. The introductory text is revised to read as follows:

§1.907–0 Outline of regulation provisions for section 907.

This section lists the paragraphs contained in §§1.907(a)–0 through 1.907(f)–1.

* * * * * *

b. The undesignated center heading preceding the entry for §1.907(a)–0 is removed and the entry for §1.907(e)–1 is removed.

c. The undesignated center heading preceding the entry for §1.907(a)–0A is removed.

d. The entry for §1.907(a)–0A is removed.

e. The entry for §1.907(a)–1A is removed.

f. The entry for §1.907(b)–1A is removed.

g. The entry for §1.907(b)–2A is removed.

h. The entry for §1.907(c)–1A is removed.

i. The entry for §1.907(c)–2A is removed.

j. The entry for §1.907(c)–3A is removed.

k. The entry for §1.907(d)–1A is removed.

l. The entry for §1.907(e)–1A is removed.

m. The entry for §1.907(f)–1A is removed.

35. Section 1.907(e)–1 is removed.
36. The undesignated center heading preceding §1.907(a)–0A is removed.
37. Section 1.907(a)–0A is removed.
38. Section 1.907(a)–1A is removed.
39. Section 1.907(b)–1A is removed.
40. Section 1.907(b)–2A is removed.
41. Section 1.907(c)–1A is removed.
42. Section 1.907(c)–2A is removed.
43. Section 1.907(c)–3A is removed.
44. Section 1.907(d)–1A is removed.
45. Section 1.907(e)–1A is removed.
46. Section 1.907(f)–1A is removed.
47–48. Section 1.995–7 is removed.
49. The undesignated center heading ''INCOME AVERAGING'' preceding §1.1301–0 is removed.
50. Section 1.1301–0 is removed.
51. Section 1.1301–1 is removed.
52. Section 1.1302–1 is removed.
53. Section 1.1302–2 is removed.
54. Section 1.1302–3 is removed.
55–56. Section 1.1303–1 is removed.
57. Section 1.1304–1 is removed.
58. Section 1.1304–2 is removed.
59. Section 1.1304–3 is removed.
60. Section 1.1304–4 is removed.
61. Section 1.1304–5 is removed.
62. Section 1.1304–6 is removed.

PART 20—ESTATE TAX; ESTATES OF DECEDENTS DYING AFTER AUGUST 16, 1954

Par. 2. Section 20.2035–1 is removed.

PART 23—[REMOVED]

Par. 3. Part 23 is removed.

PART 24—[REMOVED]

Par. 4. Part 24 is removed.

PART 25—GIFT TAX; GIFTS MADE AFTER DECEMBER 31, 1954

Par. 5. Section 25.2517–1 is removed.

PART 27—[REMOVED]

Par. 6. Part 27 is removed.

PART 33—[REMOVED]

Par. 7. Part 33 is removed.

PART 38—[REMOVED]

Par. 8. Part 38 is removed.

PART 301—PROCEDURE AND ADMINISTRATION

Par. 9. Part 301 is amended as follows:

1. Section 301.6676–1 is removed.
2. Section 301.7424–1 is removed.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 10. In §602.101, paragraph (c) is amended by removing the following entries from the table:

§602.101 OMB Control numbers.

* * * * * *

(c) * * *

CFR part or section where identified and described	Current OMB control number
* * * * * *	
1.820–2	1545–0128
* * * * * *	
1.824–1	1545–1027
1.824–3	1545–1027
* * * * * *	
1.1304–1	1545–0074
1.1304–3	1545–0074
1.1304–5	1545–0074
20.2035–1	1545–0015
* * * * * *	
27.642–1	1545–0020
* * * * * *	
38.6302–1	1545–0257
* * * * * *	

Margaret Milner Richardson,
Commissioner of Internal Revenue.

Approved December 18, 1995.

Leslie Samuels,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on January 5, 1996, 8:45 a.m., and published in the issue of the Federal Register for January 8, 1996, 61 F.R. 515)

Notice 96–14

Disallowance of Deductions for Employee Remuneration in Excess of $1,000,000; Correction

AGENCY: Internal Revenue Service, Treasury.

ACTION: Correction to final regulations.

SUMMARY: This document contains corrections to final regulations (TD 8650) [1996–10 I.R.B. 5] which were published in the Federal Register on Wednesday, December 20, 1995 (60 FR 65534), and relates to the disallowance of deductions for employee remuneration in excess of $1,000,000.

EFFECTIVE DATE: December 20, 1995.

FOR FURTHER INFORMATION CONTACT: Robert Misner or Charles T. Deliee at (202) 622-6060 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

The final regulations that are the subject of these corrections are under section 162(m) of the Internal Revenue Code.

Need for Correction

As published, the final regulations (TD 8650) contain errors that are misleading and in need of clarification.

Correction of Publication

Accordingly, the publication of the final regulations (TD 8650), which was the subject of FR Doc. 95-30869, is corrected as follows:

§ 1.162–27 [Corrected]

1. On page 65538, column 1, § 1.162–27 (c)(3)(ii)(A), line 2, the language ''3121(a)(1) through section 3121(a)(5)(D)'' is corrected to read ''3121(a)(5)(A) through section 3121(a)(5)(D)''.

2. On page 65543, column 2, § 1.162–27 (e)(4)(i), the last sentence is corrected to read as follows:

* * * * * *

(e) * * *

(4) * * * (i) * * * The material terms include the employees eligible to receive compensation; a description of the business criteria on which the performance goal is based; and either the maximum amount of compensation that could be paid to any employee or the formula used to calculate the amount of compensation to be paid to the employee if the performance goal is attained (except that, in the case of a formula based, in whole or in part, on a percentage of salary or base pay, the maximum dollar amount of compensation that could be paid to the employee must be disclosed).

* * * * * *

3. On page 65544, column 3, § 1.162–27 (e)(5), second line from the bottom of the paragraph, the language ''to the increase in the stock of the'' is corrected to read ''to the increase in the value of the stock of the''.

Cynthia E. Grigsby,
Chief, Regulations Unit,
Assistant Chief Counsel (Corporate).

(Filed by the Office of the Federal Register on January 5, 1996, 8:45 a.m., and published in the issue of the Federal Register for February 6, 1996, 61 F.R. 4349)

Part IV. Items of General Interest

Notice of Proposed Rulemaking

FUTA Taxation of Amounts Under Employee Benefit Plans

EE–55–95

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations under section 3306(r)(2) of the Internal Revenue Code, relating to when amounts deferred under or paid from certain nonqualified deferred compensation plans are taken into account as ''wages'' for purposes of the employment taxes imposed by the Federal Unemployment Tax Act (FUTA). The regulations provide guidance to taxpayers who must comply with section 3306(r)(2), which was added to the Code by section 324 of the Social Security Amendments of 1983.

DATES: Written comments and requests for a public hearing must be received by April 24, 1996.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (EE–55–95), Room 5228, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. In the alternative, submissions may be hand delivered between the hours of 8 a.m. and 5 p.m. to CC:DOM:CORP:R (EE–55–95), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: David N. Pardys, (202) 622-4606 (not a toll-free number), concerning the regulations, and Michael Slaughter, (202) 622-7190 (not a toll-free number), concerning submissions.

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed amendments to the Employment Tax Regulations (26 CFR part 31) under section 3306(r)(2) of the Internal Revenue Code of 1986 (the ''Code'') relating to the employment tax treatment of amounts deferred under or paid from certain nonqualified compensation plans. These amendments are proposed to reflect the statutory changes made by section 324 of the Social Security Amendments of 1983 (the ''1983 Amendments''), which added section 3306(r)(2) to the Code, and section 2662(f)(2) of the Deficit Reduction Act of 1984 (DEFRA), which amended section 324 of the 1983 Amendments.

Explanation of Provisions

These proposed regulations provide guidance under section 3306(r)(2), relating to when amounts deferred under or paid from certain nonqualified deferred compensation plans are taken into account as wages for FUTA purposes. These rules are substantially similar to the rules applicable to the FICA (Federal Insurance Contributions Act) tax treatment of such amounts deferred under section 3121(v)(2). Thus, these regulations cross-reference the proposed regulations under section 3121(v)(2).

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to these regulations, and, therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Comments and Requests for a Public Hearing

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

Drafting Information

The principal author of these regulations is David N. Pardys, Office of the Associate Chief Counsel (Employee Benefits and Exempt Organizations), IRS. However, other personnel from the IRS and Treasury Department participated in their development.

* * * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 31 is proposed to be amended as follows:

PART 31—EMPLOYMENT TAXES AND COLLECTION OF INCOME TAX AT SOURCE

Paragraph 1. The authority citation for part 31 continues to read in part as follows:

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

Par. 2. Section 31.3306(r)(2)–1 is added to read as follows:

§ 31.3306(r)(2)–1 Treatment of amounts deferred under certain nonqualified deferred compensation plans.

(a) *In general.* Section 3306(r)(2) provides a special timing rule for the tax imposed by section 3301 with respect to any amount deferred under a nonqualified deferred compensation plan. Section 31.3121(v)(2)–1[1] contains rules relating to when amounts deferred under certain nonqualified deferred compensation plans are wages for purposes of sections 3121(v)(2), 3101,

[1]This section appears as a notice of proposed rulemaking published elsewhere in this issue of the *Federal Register*.

and 3111. Those rules also apply to the special timing rule of section 3306(r)(2). For purposes of applying those rules to section 3306(r)(2) and this paragraph (a), references in those rules to the Federal Insurance Contributions Act are considered references to the Federal Unemployment Tax Act (26 U.S.C. 3301 et seq.), references to FICA are considered references to FUTA, references to section 3101 or 3111 are considered references to section 3301, references to section 3121(v)(2) are considered references to section 3306(r)(2), references to section 3121(a), 3121(a)(5), and 3121(a)(13) are considered references to sections 3306(b), 3306(b)(5), and 3306(b)(10), respectively, and references to §31.3121(a)–2(a) are considered references to §31.3301–4.

(b) *Effective dates and transition rules*. Except as otherwise provided, section 3306(r)(2) applies to remuneration paid after December 31, 1984. Section 31.3121(v)(2)–2[2] contains effective date rules for certain remuneration paid after December 31, 1983, for purposes of section 3121(v)(2). Those rules also apply to section 3306(r)(2). For purposes of applying those rules to section 3306(r)(2) and this paragraph (b), references to section 3121(v)(2) are considered references to section 3306(r)(2), and references to section 3121(a)(2), 3121(a)(3), or 3121(a)(13) are considered references to section 3306(b)(2), 3306(b)(3), or 3306(b)(10), respectively. In addition, references to section 324(d)(1) of the Social Security Amendments of 1983 are considered references to section 324(d)(2) of the Social Security Amendments of 1983, and references to §31.3121(v)(2)–1 are considered references to paragraph (a) of this section. In addition, the rules of §31.3121(v)(2)–2 shall apply to this paragraph by—

(1) References to ''December 31, 1983'' are considered references to ''December 31, 1984'';

(2) References to ''before 1984'' are considered references to ''before 1985'';

(3) References to ''Federal Insurance Contributions Act'' are considered references to ''Federal Unemployment Tax Act''; and

(4) References to ''FICA'' are considered references to ''FUTA''.

Margaret Milner Richardson,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on January 19, 1996, 12:52 p.m., and published in the issue of the Federal Register for January 25, 1996, 61 F.R. 2214)

[2]This section appears as a notice of proposed rulemaking published elsewhere in this issue of the *Federal Register*.

Notice of Proposed Rulemaking

FICA Taxation of Amounts Under Employee Benefit Plans

EE–142–87

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations under section 3121(v)(2) of the Internal Revenue Code of 1986, relating to when amounts deferred under or paid from certain nonqualified deferred compensation plans are taken into account as ''wages'' for purposes of the employment taxes imposed by the Federal Insurance Contributions Act (FICA). The regulations provide guidance to taxpayers who must comply with section 3121(v)(2), which was added to the Code by section 324 of the Social Security Amendments of 1983.

DATES: Written comments and requests for a public hearing must be received by April 24, 1996.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (EE–142–87), Room 5228, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. In the alternative, submissions may be hand delivered between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (EE–142–87), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: David N. Pardys, (202) 622-4606 (not a toll-free number), concerning the regulations, and Michael Slaughter, (202) 622-7190 (not a toll-free number), concerning submissions.

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed amendments to the Employment Tax Regulations (26 CFR part 31) under section 3121(v)(2) of the Internal Revenue Code of 1986 (the ''Code'') relating to the employment tax treatment of amounts deferred under or paid from certain nonqualified deferred compensation plans. These amendments are proposed to reflect the statutory changes made by section 324 of the Social Security Amendments of 1983 (the ''1983 Amendments''), which added section 3121(v)(2) to the Code, and section 2662(f)(2) of the Deficit Reduction Act of 1984 (DEFRA), which amended section 324 of the 1983 Amendments.

Explanation of Provisions

Sections 3101 and 3111 of the Code impose FICA tax on employees and employers, respectively. FICA tax consists of the Old-Age, Survivors, and Disability Insurance (OASDI) tax and the Hospital Insurance (HI) tax, and generally is computed as a percentage of wages (as defined in section 3121(a)) with respect to employment. Subject to specific exceptions, section 3121(a) defines ''wages'' as all remuneration for employment. Existing regulations (§31.3121(a)–2(a)) provide that FICA tax is imposed at the time the remuneration is actually or constructively paid.

Prior to the 1983 Amendments, benefits under a nonqualified deferred compensation plan generally were wages subject to FICA tax at the time they were actually or constructively paid, unless certain retirement-related exclusions applied. These exceptions (former section 3121(a)(2)(A), (a)(3), and (a)(13)(A)(iii)) were repealed by the 1983 Amendments. Thus, under the 1983 Amendments, which generally apply to remuneration paid after December 31, 1983, ''retirement'' payments are no longer excluded from wages. Instead, the 1983 Amendments added section 3121(v)(2), which provides a special timing rule for wages (within the meaning of section 3121(a)) that constitute an amount deferred

under a nonqualified deferred compensation plan.[1]

Under section 3121(v)(2)(A), any ''amount deferred'' under a nonqualified deferred compensation plan must be taken into account as wages for FICA purposes as of the later of (1) when the services are performed, or (2) when there is no substantial risk of forfeiture of the rights to such amount. This special timing rule may result in imposition of FICA tax before the benefit payments under the plan begin, thus accelerating the imposition of FICA tax on benefits under a nonqualified deferred compensation plan.

Section 3121(v)(2)(B) provides a special exclusion (the ''nonduplication rule'') that prevents double taxation. Once an amount deferred under a nonqualified deferred compensation plan is ''taken into account'' as wages under the special timing rule, the nonduplication rule provides that neither that amount nor the ''income attributable to that amount'' is again treated as FICA wages. Thus, benefit payments under a nonqualified deferred compensation plan are not subject to FICA tax when actually or constructively paid (*i.e.,* under the general timing rule for wage inclusion) if the benefit payments consist of amounts deferred under the plan that were previously taken into account as FICA wages under the special timing rule plus the attributable income.

Conversely, benefits under a nonqualified plan are subject to FICA tax when actually or constructively paid to the extent the benefits relate to an amount deferred that was not previously taken into account under the special timing rule.

Section 3121(a)(1) imposes a dollar limit on the annual amount of wages that is subject to the OASDI portion of FICA tax. Section 13207 of the Omnibus Budget Reconciliation Act of 1993 repealed the dollar limit on annual wages subject to the HI portion of FICA tax, effective for 1994 and later years.

[1]The 1983 Amendments did not amend the definition of net earnings from self-employment under section 1402(a) of the Code or the timing of the tax on self-employment income under section 1401 of the Code. Accordingly, the special timing rule under section 3121(v)(2) does not apply to nonqualified deferred compensation that constitutes net earnings from self-employment.

Overview of Regulations

In contrast to most FICA wages, nonqualified deferred compensation is subject to FICA tax not when paid, but earlier—generally when the related services are performed. (FICA taxation is deferred if the compensation is subject to a substantial risk of forfeiture.) A benefit that was subject to FICA tax at this earlier date generally is not subject to tax again when paid to the participant. Applying these statutory rules often requires difficult valuations of future benefits.

Recognizing the practical administrative problems that can be encountered by taxpayers in this area, the proposed regulations are designed to be workable, to minimize complexity, and to provide appropriate flexibility for taxpayers. For example, the regulations:

- *Permit use of any reasonable assumptions*. For the purpose of calculating the present value of a benefit earned in a given year (an ''amount deferred'' under the statute), the regulations do not prescribe specific actuarial assumptions or methods that must be used. Instead, the regulations simply allow taxpayers to determine present value using any reasonable actuarial assumptions and methods.
- *Establish a reasonably ascertainable rule*. In some cases, uncertainties pertaining to future benefits make it especially difficult to determine the present value of a benefit (for example, where a benefit can fluctuate depending on the varying amount of a qualified plan benefit). In such cases, under the regulations, the present value of the benefit need not be included in FICA wages (''taken into account'') until it becomes reasonably ascertainable.
- *Provide flexibility with respect to withholding*. The regulations ease the administrative burdens of withholding by permitting payors to delay the inclusion of any deferred compensation in wages until the end of the year. In addition, where amounts deferred cannot be readily calculated by year-end, the payor may either estimate the amounts (and make later adjustments without interest or penalties) or postpone the inclusion in wages until the first quarter of the following year.
- *Provide reasonable, good faith transition relief*. The regulations provide transition relief for actions taken before the effective date of the regulations based on a reasonable, good faith interpretation of the statute.

Structure of the Regulations

The regulations generally consist of three parts. The first part of the regulations, paragraphs (a) and (b), describes the special timing rule and the related nonduplication rule of section 3121(v)(2), defines a nonqualified deferred compensation plan, and specifies the types of benefits that are subject to the special timing rule. The second part of the regulations, paragraphs (c), (d), and (e), describes how the special timing rule and the nonduplication rule operate. In the remainder of the regulations, paragraph (f) provides withholding rules, paragraph (g) contains the regulatory effective date and the transition rules, and §31.3121(v)–2 sets forth the statutory effective dates.

The most significant items included in these regulations are discussed below.

Definition of Nonqualified Deferred Compensation Plan

In general. Section 3121(v)(2)(C) of the Code defines a ''nonqualified deferred compensation plan'' as any plan or arrangement established and maintained by an employer for one or more of its employees that provides for the deferral of compensation, other than a plan described in section 3121(a)(5) (such as qualified plans and certain other plans and arrangements). The regulations provide that a ''nonqualified deferred compensation plan'' is a plan that is ''established'' by an employer for one or more of its employees, and that provides for the ''deferral of compensation.'' A plan may constitute a nonqualified deferred compensation plan under section 3121(v)(2), regardless of whether it is an employee benefit plan under section 3(3) of the Employee Retirement Income Security Act of 1974, as amended (ERISA), whether deferrals under the plan are made pursuant to the employee's election, or whether the amounts deferred are treated as deferred for income tax purposes.

Requirement that the plan be established. The regulations provide that an amount deferred may not be taken into account as FICA wages before the plan is established, and that a plan is considered ''established'' on the latest of the date on which the plan is adopted, the date on which it is

effective, or the date on which its material terms are set forth in writing. Transition relief is provided for unwritten plans that were adopted and effective before March 25, 1996. Such a plan is treated as established with respect to an employee as of the later of the date on which it was adopted or became effective, provided that it is set forth in writing within six months after publication of the final regulations.

Requirement that the plan provide for the deferral of compensation. In general, the regulations specify that a plan provides for the ''deferral of compensation'' only if an employee has a legally binding right to compensation that has not been actually or constructively received and that is payable in a later year. However, the regulations provide that there is no ''deferral of compensation'' merely because compensation is paid after the last day of a calendar year pursuant to the employer's customary payment scheme for compensation. Thus, if one week of an employer's customary two-week payroll period falls in one year and the second week of the period falls in the next year, the compensation paid at the end of the two-week period on account of the services rendered in the first week is not considered deferred compensation and is not subject to the special timing rule.

The regulations also provide a rule of administrative convenience for ''short-term'' deferrals. Under this rule, an employer may choose to treat an amount that is deferred from one calendar year to a date that is no more than a brief period of time after the end of that calendar year as if it were subject to the general timing rule (*i.e.,* treated as FICA wages when actually or constructively paid) instead of the special timing rule.

Plans, arrangements, and benefits that do not provide for the deferral of compensation. Consistent with the legislative history relating to section 3121(v)(2), certain types of plans, arrangements, and benefits are not covered by the special timing rule of section 3121(v)(2), even though they may be viewed in other contexts as providing for the deferral of compensation.

The regulations provide that stock options, stock appreciation rights (described in Revenue Ruling 80–300, 1980–2 C.B. 165), and certain other stock-related rights do not provide for the deferral of compensation for FICA tax purposes, even though there may be no amount recognized for income tax purposes until after the calendar year of grant. In contrast, the regulations specify that a ''phantom'' stock plan that awards a right to a fixed payment equal to the value of a specified number of shares of employer stock may be treated as providing benefits that result from the deferral of compensation for purposes of section 3121(v)(2). Such a plan typically involves the employer's unfunded, unsecured promise to pay compensation in the future that is measured by the value of a specified number of shares of stock on the date of payment. A phantom stock plan is a nonqualified deferred compensation plan under which the earnings portion of the future compensation is based on the change in the value of the employer's stock, rather than, for example, an equity mutual fund or a specified rate of interest.

The regulations provide that certain welfare benefits, including vacation benefits, sick leave, compensatory time, disability pay, severance pay, and death benefits, do not result from the deferral of compensation for FICA purposes. Neither section 3121(v) nor the legislative history relating to section 3121(v) indicates that Congress intended to modify the long-established FICA tax treatment of such benefits.

Nothing in the regulations is intended to determine the amount or the timing of an employer's deduction for contributions to any type of welfare benefit plan, including a plan that provides severance benefits. Similarly, although the regulations include a severance pay plan under a heading titled ''certain welfare benefits,'' no inference is intended that a severance plan is treated as a welfare benefit plan under any other section of the Code.

The regulations provide that certain other payments are not subject to the special timing rule of section 3121(v)(2). In describing the Senate Finance Committee proposal on golden parachutes, the Conference Report to DEFRA states that ''payments under golden parachute contracts, *like termination pay*, are to be subject to FICA taxes when paid.'' (Emphasis added.) Conf. Rpt. 98–861, p. 85. Consistent with this legislative history, the regulations provide that excess golden parachute payments and window benefits do not result from the deferral of compensation and, thus, are not subject to the special timing rule.

Similarly, certain benefits established within 12 months prior to an employee's termination of employment are treated as termination pay that is not subject to the special timing rule. This provision is intended to ensure that termination pay is subject to FICA tax when it is paid, even where there is no explicit agreement to terminate employment. The regulations provide that a benefit established within 12 months prior to an employee's termination of employment is treated as termination pay only if the facts and circumstances indicate that the benefit was provided in contemplation of the employee's impending termination of employment.

Benefits established after termination of employment also do not result from the deferral of compensation. In addition, there is no deferral of compensation where the facts and circumstances indicate that the compensation is paid for current services.

Determination of the Amount Deferred

The ''amount deferred'' under a nonqualified deferred compensation plan for a period is the amount that must be taken into account as wages for that period under the special timing rule of section 3121(v)(2)(A). Under the regulations, the manner in which the amount deferred for a period is determined depends upon whether the nonqualified deferred compensation plan is an account balance plan or a nonaccount balance plan.

Account balance plans. The regulations provide that, if benefits for an employee are provided under an account balance plan, the amount deferred equals the principal amount credited to the employee's account for the period, increased or decreased by any income attributable to that amount through the date such amount is required to be taken into account as FICA wages. For purposes of the regulations, a nonqualified deferred compensation plan is an ''account balance plan'' only if, under the terms of the plan, (1) principal amounts are credited to an individual account for an employee, (2) the income attributable to the principal amounts is credited (or debited) to the individual account, and (3) the benefits payable to the employee are based solely on the

balance credited to the individual account.

Nonaccount balance plans. If a nonqualified deferred compensation plan is not an account balance plan, the regulations provide that the amount deferred for a period equals the present value of the additional future payments to which the employee has obtained a legally binding right during that period. For purposes of determining present value, the regulations give employers the flexibility to use any reasonable actuarial assumptions and methods.

''Taken Into Account'' Defined

An amount deferred is treated as ''taken into account'' when it is included in computing the amount of FICA wages, but only if any additional FICA tax for the year (including any interest and penalties due if the payment is late) that results from the inclusion is actually paid before the period of limitations is closed for the year. For years before 1994, the amount deferred is treated as taken into account even if its inclusion does not result in any additional FICA tax liability. For example, if, in 1993, an employee participating in a nonqualified deferred compensation plan had other wages that were at least equal to the applicable OASDI and HI wage bases for 1993, the inclusion in wages of an amount deferred would not have resulted in any additional FICA tax liability for that year. Nonetheless, the amount deferred would have been considered taken into account as wages for purposes of section 3121(v)(2).

Nonduplication Rule

As noted above, under the nonduplication rule of section 3121(v)(2)(B), if an amount deferred is taken into account as wages under the special timing rule, neither the amount deferred nor the related income is included in FICA wages when benefits attributable to that amount are paid.

If an amount deferred is not taken into account as wages under the special timing rule, then benefits attributable to that amount are required to be included as wages when actually or constructively paid in accordance with the general timing rule. For this purpose, a Form W–2 (Wage and Tax Statement) for an earlier (post-1993) year showing FICA wages in excess of taxable income for the year and an explanation showing that the payment is attributable to the excess could, for example, be used by a taxpayer to demonstrate that the payment is attributable to an amount deferred that was previously taken into account as wages under the special timing rule. If a payment is attributable to an amount deferred only a portion of which was previously taken into account, the portion of the payment that is excluded from wages pursuant to the nonduplication rule and the portion that is included in wages under the general timing rule are generally determined on a pro rata basis.

Income Attributable to an Amount Deferred

Account balance plans. In the case of an account balance plan, the regulations define ''income attributable to the amount taken into account'' as any increase or decrease in the amount credited to an employee's account that, under the terms of the plan, is attributable to an amount previously taken into account, but only if the income is based on a rate of return that does not exceed either (1) the actual rate of return on a predetermined actual investment, or (2) if no predetermined actual investment has been specified, a reasonable rate of interest. If the rate of return credited under the plan is not reasonable, the income attributable to the amount taken into account is limited to the mid-term applicable federal rate (as defined in section 1274(d)) for the first day of the calendar year (the ''AFR''). However, in the case of a predetermined actual investment, if the actual rate of return on that investment is lower than the AFR, the income attributable to the amount taken into account is limited to the that actual rate of return. Any excess of the income credited under the plan over the income determined using the AFR (or the actual rate of return, if applicable) is considered an additional amount deferred in the year credited, and is required to be taken into account in that year under the special timing rule.

Nonaccount balance plans. In the case of a nonaccount balance plan, the regulations define the ''income attributable to the amount taken into account'' as the increase, due solely to the passage of time, in the present value of any future payments to which the employee has obtained a legally binding right, determined using reasonable actuarial assumptions and methods. Thus, if an amount deferred for a period is determined using a reasonable interest rate and other reasonable actuarial assumptions and methods, and that amount is taken into account when required under the special timing rule, none of the future payments attributable to that amount will be subject to FICA tax when paid.

If any actuarial assumption or method is not reasonable, then the income attributable to the amount taken into account is limited to the income that would result from the application of the AFR and, if applicable, the applicable mortality table under section 417(e) of the Code, both determined as of January 1 of the calendar year in which the amount was taken into account. If the present value of the future benefit payments (determined using the AFR and the section 417(e) mortality table) exceeds the amount taken into account plus attributable income (as limited by using those same assumptions), a portion of each benefit payment will be excluded from wages under the nonduplication rule and a portion will be included in wages under the general timing rule.

Time Amounts Deferred Are Taken Into Account

Under the special timing rule, an amount deferred is required to be taken into account as FICA wages as of the later of when (1) the services are performed or (2) the right to the amount deferred is no longer subject to a substantial risk of forfeiture. However, the regulations allow an amount deferred to be taken into account at a later date if all or a portion of the amount deferred is not ''reasonably ascertainable'' until that later date. In addition, consistent with Notice 94–96, 1994–2 C.B. 564, the regulations provide that no amount deferred under a nonqualified deferred compensation plan may be taken into account as FICA wages before the plan is established.

Services creating the right to an amount deferred. The regulations provide that services creating the right to an amount deferred are considered performed when, under the terms of the plan and the relevant facts and circumstances, the employee has performed all

of the services necessary to obtain a legally binding right to the amount deferred, disregarding any substantial risk of forfeiture.

Substantial risk of forfeiture. In accordance with the legislative history relating to section 3121(v)(2), the regulations define a substantial risk of forfeiture for purposes of the special timing rule of section 3121(v)(2) in accordance with the principles of section 83. Thus, in general, whether or not a substantial risk of forfeiture exists will depend on the facts and circumstances. See §1.83–3(c) of the regulations.

Amounts deferred that are not reasonably ascertainable. A number of commentators have emphasized the problems that would arise if certain amounts deferred were required to be taken into account while still highly uncertain and subject to fluctuation. For example, under a nonaccount balance plan, an amount deferred (and taken into account as wages) for a year might decrease, or even be eliminated, in a later year on account of changes in the limitations on contributions and benefits imposed on qualified plans under section 401(a)(17) or 415, the amount of an employee's future compensation, the date on which payments commence, or the form of benefit elected by an employee. (The possibility that benefits may decrease because of these contingencies does not, however, generally cause the benefits to be subject to a substantial risk of forfeiture within the meaning of section 83 or, therefore, section 3121(v)(2).)

Because these types of contingencies generally cannot be predicted with a high degree of certainty for an individual employee, the regulations provide that an amount deferred under a nonaccount balance plan is not required to be taken into account as wages until the earliest date on which the amount deferred is reasonably ascertainable (the ''resolution date''). An amount deferred is ''reasonably ascertainable'' when there are no actuarial or other assumptions needed to determine the amount deferred, other than interest, mortality, or cost-of-living assumptions.

Thus, for example, if assumptions relating to qualified plan offset variables, future pay, or the time or form of benefit payments are needed to determine the amount deferred at the time the services are performed (or, if applicable, when the benefit is no longer subject to a substantial risk of forfeiture), the employer may choose to delay taking the amount deferred into account until the only assumptions needed to determine the amount deferred are those relating to interest, mortality, and cost of living. An employer may choose to use this rule for all of an amount deferred, even if only a portion of the amount deferred is not reasonably ascertainable. For example, if the only portion of an amount deferred that is not reasonably ascertainable is an early retirement subsidy, no portion of the amount deferred is required to be taken into account until the contingency relating to early retirement has been resolved.

On the resolution date, the amount deferred and the related income must be determined in accordance with the rules that generally apply to determine those amounts under a nonaccount balance plan. The rules that generally apply to determine whether an amount deferred is actually taken into account as wages, and the consequences if it is not so taken into account, also apply.

An employer may choose to take an amount into account on a date (the ''early inclusion date'') that precedes the resolution date. However, if the amount taken into account at the early inclusion date (plus related income through the resolution date) is less than the resolution date amount, then the employer must ''true up'' by taking the balance of the resolution date amount into account as of the resolution date. If the amount taken into account at the early inclusion date (plus related income) exceeds the resolution date amount, the taxpayer may claim a refund or credit, in accordance with sections 6402 and 6413, for any overpayment of FICA tax in open years.

Rule of administrative convenience. The regulations provide that an employer may treat an amount deferred as required to be taken into account on a date that is later than, but within the same calendar year as, the actual date on which the amount deferred is otherwise required to be taken into account. Thus, for example, if an employee obtains a legally binding right to an amount deferred mid-year, the employer may take the amount deferred into account on any later date within the same year (*e.g.,* December 31).

Withholding

For purposes of withholding and depositing FICA tax, an amount deferred under a nonqualified deferred compensation plan generally is treated as wages paid by the employer and received by the employee at the time it is taken into account under section 3121(v)(2) and these regulations. However, in certain situations, the employer may be unable to readily calculate the amount deferred for a year by December 31 of that year. The regulations provide two alternative methods for withholding and depositing FICA tax in these situations.

Under the ''estimated method,'' an employer may treat a reasonably estimated amount as wages paid on the last day of the calendar year (the ''first year''). If the employer underestimates the amount deferred that should have been taken into account and, therefore, deposits less FICA tax than the amount due, the employer may choose to treat the shortfall as wages either in the first year or in the first quarter of the next year. If the employer treats the shortfall as wages in the first year and the shortfall was not included on the employee's Form W–2, the employer must issue Form W–2c. In addition, the employer must correct the information on the Form 941 for the last quarter of the first year. In such a case, the shortfall will not be considered a late deposit subject to penalty if it is deposited by the employer's first regular deposit date following the first quarter of the next year. Conversely, if the employer overestimates the amount deferred that should have been taken into account as wages on the last day of the year, the employer may claim a refund or credit in accordance with sections 6402 and 6413.

Under the second alternative method, the ''lag method,'' an employer may calculate the end-of-year amount deferred on any date in the first quarter of the next calendar year. The amount deferred will be treated as wages on that date, and the amount deferred that would otherwise have been taken into account on the last day of the year must be increased by income through the date on which the amount is taken into account.

Effective Date of the Regulations

Proposed effective date. These regulations generally are proposed to be effective for amounts deferred and benefits paid on or after January 1, 1997.

Comments and Requests for a Public Hearing

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

Drafting Information

The principal author of these regulations is David N. Pardys, Office of the Associate Chief Counsel (Employee Benefits and Exempt Organizations), IRS. However, other personnel from the IRS and Treasury Department participated in their development.

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Proposed Amendments to the Regulations

Accordingly, 26 CFR part 31 is proposed to be amended as follows:

PART 31—EMPLOYMENT TAXES AND COLLECTION OF INCOME TAX AT SOURCE

Paragraph 1. The authority citation for part 31 continues to read in part as follows:

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

Par. 2. Sections 31.3121(v)(2)–1 and 31.3121(v)(2)–2 are added to read as follows:

§ 31.3121(v)(2)–1 Treatment of amounts deferred under certain nonqualified deferred compensation plans.

(a) *Timing of wage inclusion*—(1) *General timing rule for wages*. Remuneration for employment that constitutes wages within the meaning of section 3121(a) of the Internal Revenue Code generally is taken into account for purposes of the Federal Insurance Contributions Act (FICA) taxes imposed under sections 3101 and 3111 of the Internal Revenue Code at the time the remuneration is actually or constructively paid. See §31.3121(a)–2(a).

(2) *Special timing rule for an amount deferred under a nonqualified deferred compensation plan*—(i) *In general*. To the extent that remuneration deferred under a nonqualified deferred compensation plan constitutes wages within the meaning of section 3121(a), the remuneration is subject to the special timing rule described in this paragraph (a)(2). Remuneration is considered deferred under a nonqualified deferred compensation plan within the meaning of section 3121(v)(2) and this section only if it is provided pursuant to a plan described in paragraph (b) of this section. The amount deferred under a nonqualified deferred compensation plan is determined under paragraph (c) of this section.

(ii) *Special timing rule*. Except as otherwise provided in this section, an amount deferred under a nonqualified deferred compensation plan is required to be taken into account as wages for FICA purposes as of the later of—

(A) The date on which the services creating the right to that amount are performed (within the meaning of paragraph (e)(2) of this section); or

(B) The date on which the right to that amount is no longer subject to a substantial risk of forfeiture (within the meaning of paragraph (e)(3) of this section).

(iii) *Inclusion in wages only once (nonduplication rule)*. Once an amount deferred under a nonqualified deferred compensation plan is taken into account (within the meaning of paragraph (d)(1) of this section), then neither the amount taken into account nor the income attributable to the amount taken into account (within the meaning of paragraph (d)(2) of this section) is treated as wages for FICA purposes at any time thereafter.

(iv) *Benefits that do not result from a deferral of compensation*. If a nonqualified deferred compensation plan (within the meaning of paragraph (b)(1) of this section) provides both a benefit that results from the deferral of compensation (within the meaning of paragraph (b)(3) of this section) and a benefit that does not result from the deferral of compensation, the benefit that does not result from the deferral of compensation is not subject to the special timing rule described in this paragraph (a)(2).

(v) *Remuneration that does not constitute wages*. If remuneration deferred under a nonqualified deferred compensation plan does not constitute wages within the meaning of section 3121(a), then that remuneration is not taken into account as wages for FICA purposes under either the general timing rule described in paragraph (a)(1) of this section or the special timing rule described in this paragraph (a)(2). For example, benefits under a death benefit plan described in section 3121(a)(13) of the Internal Revenue Code do not constitute wages for FICA purposes. Therefore, these benefits are not included as wages under the general timing rule described in paragraph (a)(1) of this section or the special timing rule described in this paragraph (a)(2), even if the death benefit plan would otherwise be considered a nonqualified deferred compensation plan within the meaning of paragraph (b)(1) of this section.

(b) *Nonqualified deferred compensation plan*—(l) *In general*—(i) *Defined*. For purposes of this section, the term ''nonqualified deferred compensation plan'' means any plan or other arrangement that is established (within the meaning of paragraph (b)(2) of this section) by an employer for one or more of its employees, and that provides for the deferral of compensation (within the meaning of paragraph (b)(3) of this section), other than a plan described in section 3121(a)(5). A nonqualified deferred compensation plan may be adopted unilaterally by the employer or may be negotiated between or agreed to by the employer and one or more employees or employee representatives. A plan may constitute a nonqualified deferred compensation plan under this section without regard to whether the deferrals under the plan are made pursuant to an election by the employee or whether the amounts deferred are treated as deferred compensation for income tax purposes (*e.g.,* whether the amounts are subject to the deduction rules of section 404). In addition, a plan may constitute a nonqualified deferred compensation plan under this section whether or not it is an employee benefit plan under section 3(3) of the Employee Retirement Income Security Act of 1974, as amended.

(ii) *Plan includes plan or other arrangement*. For purposes of this section, except where the context indicates

otherwise, the term ''plan'' includes a plan or other arrangement.

(2) *Plan establishment*—(i) *Date plan is established*. For purposes of this section, a plan is ''established'' on the latest of the date on which it is adopted, the date on which it is effective, or the date on which the material terms of the plan are set forth in writing. For purposes of this section, a plan also will be deemed to be set forth in writing if it is set forth in any other form that is approved by the Commissioner. The material terms of the plan include the amount (or the method or formula for determining the amount) of deferred compensation to be provided under the plan and the time when it may or will be provided.

(ii) *Plan amendments*. In the case of an amendment that increases the amount deferred under a nonqualified deferred compensation plan, the plan is not considered established with respect to the additional amount deferred until the plan, as amended, satisfies the requirements of paragraph (b)(2)(i) of this section.

(iii) *Transition rule*. For purposes of this section, an unwritten plan that is adopted and effective before March 25, 1996, is treated as established under this section as of the later of the date on which it was adopted or became effective, provided that it is set forth in writing not later than [*Date that is six months after the date of publication of final regulations in the Federal Register*].

(3) *Plan must provide for the deferral of compensation*—(i) *Deferral of compensation defined*. A plan provides for the ''deferral of compensation'' with respect to an employee only if, under the terms of the plan and the relevant facts and circumstances, the employee has a legally binding right during a calendar year to compensation that has not been actually or constructively received and that, pursuant to the terms of the plan, is payable in a later year. An employee does not have a legally binding right to compensation if that compensation may be unilaterally reduced or eliminated by the employer. For this purpose, compensation is not considered subject to unilateral reduction or elimination merely because it may be reduced or eliminated by operation of the objective terms of the plan, such as the application of a provision creating a substantial risk of forfeiture (within the meaning of section 83). Similarly, an employee does not fail to have a legally binding right to compensation merely because the amount of compensation is determined under a formula that provides for benefits to be offset by benefits provided under a plan that is qualified under section 401(a) of the Internal Revenue Code.

(ii) *Compensation payable pursuant to the employer's customary payment timing arrangement*. There is no deferral of compensation (within the meaning of this paragraph (b)(3)) merely because compensation is paid after the last day of a calendar year pursuant to the timing arrangement under which the employer ordinarily compensates employees for services performed during a payroll period described in section 3401(b).

(iii) *Short-term deferrals*. If, under a nonqualified deferred compensation plan, there is a deferral of compensation (within the meaning of this paragraph (b)(3)) that causes an amount to be deferred from a calendar year to a date that is no more than a brief period of time after the end of that calendar year, then, at the employer's option, that amount may be treated as if it were not subject to the special timing rule described in paragraph (a)(2) of this section. An employer may apply this option only if the employer does so for all employees covered by the plan and all substantially similar nonqualified deferred compensation plans. For purposes of this paragraph (b)(3)(iii), whether compensation is deferred to a date that is not more than a ''brief period of time'' after the end of a calendar year is determined in accordance with §1.404(b)–1T, Q&A–2, of this chapter.

(4) *Plans, arrangements, and benefits that do not provide for the deferral of compensation*—(i) *In general*. Notwithstanding paragraph (b)(3)(i) of this section, an amount or benefit described in any of paragraphs (b)(4)(ii) through (viii) of this section is not treated as resulting from the deferral of compensation for purposes of section 3121(v)(2) and this section and, thus, is not subject to the special timing rule of paragraph (a)(2) of this section.

(ii) *Stock options, stock appreciation rights and other stock value rights*. Amounts received as a result of a stock option, or as a result of a stock appreciation right or other stock value right, do not result from the deferral of compensation for purposes of section 3121(v)(2). For purposes of this paragraph (b)(4)(ii), a ''stock value right'' is a right granted to an employee with respect to one or more shares of employer stock that, to the extent exercised, entitles the employee to a payment for each share of stock equal to the excess, or a percentage of the excess, of the value of a share of the employer's stock on the date of exercise over a specified price (greater than zero). Thus, for example, the term ''stock value right'' does not include a phantom stock or other arrangement under which an employee is awarded the right to receive a fixed payment equal to the value of a specified number of shares of employer stock.

(iii) *Restricted property*. If an employee receives property from, or pursuant to a plan maintained by, an employer, there is no deferral of compensation (within the meaning of section 3121(v)(2)) merely because the value of the property is not includible in income (under section 83) in the year of receipt by reason of the property being nontransferable and subject to a substantial risk of forfeiture. However, a plan under which an employee obtains a legally binding right to receive property (whether or not the property is restricted property) in the future may provide for the deferral of compensation within the meaning of paragraph (b)(3) of this section and, accordingly, may constitute a nonqualified deferred compensation plan, even though benefits under the plan are or may be paid in the form of property.

(iv) *Certain welfare benefits*. Vacation benefits, sick leave, compensatory time, disability pay, severance pay, and death benefits do not result from the deferral of compensation for purposes of section 3121(v)(2), even if those benefits constitute wages within the meaning of section 3121(a). Benefits provided under a severance pay plan that is not an employee pension benefit plan pursuant to 29 CFR 2510.3–2(b) are considered ''severance pay'' for purposes of this paragraph (b)(4)(iv). If a plan is an employee pension benefit plan pursuant to 29 CFR 2510.3–2(b), then whether benefits payable upon an employee's termination of employment are considered severance pay for purposes of this paragraph (b)(4)(iv) depends upon the relevant facts and circumstances. Notwithstanding the

preceding sentence, a plan that is an employee pension benefit plan pursuant to 29 CFR 2510.3–2(b) is in all cases considered to provide severance pay for purposes of this paragraph (b)(4)(iv) if benefits payable under the plan upon an employee's termination of employment are payable only if that termination is involuntary.

(v) *Certain benefits provided in connection with impending termination*—(A) *In general*. Benefits provided in connection with impending termination of employment under paragraph (b)(4)(v)(B) or (b)(4)(v)(C) of this section do not result from a deferral of compensation within the meaning of section 3121(v)(2).

(B) *Window benefits*—(*1*) *In general*. For purposes of this paragraph (b)(4)(v), a window benefit is provided in connection with impending termination of employment. For this purpose, a ''window benefit'' is an early retirement benefit, retirement-type subsidy, social security supplement, or other form of benefit made available by an employer for a limited period of time (no greater than one year) to employees who terminate employment during that period or to employees who terminate employment during that period under specified circumstances.

(*2*) *Special rule for recurring window benefits*. A benefit will not be considered a window benefit if an employer establishes a pattern of repeatedly providing for similar benefits in similar situations for substantially consecutive, limited periods of time. Whether the recurrence of these benefits constitutes a pattern of amendments is determined based on the facts and circumstances. Although no one factor is determinative, relevant factors include whether the benefits are on account of a specific business event or condition, the degree to which the benefits relate to the event or condition, and whether the event or condition is temporary or discrete or is a permanent aspect of the employer's business.

(C) *Termination within 12 months of establishment of a benefit or plan*. For purposes of this paragraph (b)(4)(v), a benefit is provided in connection with impending termination of employment, without regard to whether it constitutes a window benefit, if—

(*1*) An employee's termination of employment occurs within 12 months of the establishment of the benefit or the plan providing the benefit; and

(*2*) The facts and circumstances indicate that the benefit or plan is established in contemplation of the employee's impending termination of employment.

(vi) *Benefits established after termination of employment*. Benefits established with respect to an employee after the employee's termination of employment do not result from a deferral of compensation within the meaning of section 3121(v)(2).

(vii) *Excess parachute payments*. An excess parachute payment (as defined in section 280G(b)) under an agreement entered into or renewed after June 14, 1984, in taxable years ending after such date, does not result from the deferral of compensation within the meaning of section 3121(v)(2). For this purpose, any contract entered into before June 15, 1984, that is amended after June 14, 1984 in any relevant significant aspect, is treated as a contract entered into after June 14, 1984.

(viii) *Compensation for current services*. A plan does not provide for the deferral of compensation within the meaning of section 3121(v)(2) if, based on the relevant facts and circumstances, the compensation is paid for current services.

(5) *Examples*. This paragraph (b) may be illustrated by the following examples:

Example 1. (i) In December of 1997, Employer M tells Employee A that, if specified goals are satisfied for 1998, Employee A will receive a bonus on July 1, 1999 equal to a specified percentage of 1998 compensation. Because Employee A meets the specified goals, Employer M pays the bonus to Employee A on July 1, 1999, consistent with its oral commitment.

(ii) This arrangement is not a nonqualified deferred compensation plan under this section because its terms were not set forth in writing and, therefore, it was not established in accordance with paragraph (b)(2) of this section.

Example 2. (i) Employer N establishes a compensation arrangement for Employee B in 1997. Before the beginning of 1998, Employee B and Employer N enter into a legally binding salary reduction agreement to defer a specified percentage of Employee B's salary that would otherwise be payable in 1998. The amounts deferred remain a general asset of Employer N, and are payable in 2008.

(ii) Employee B has a legally binding right during 1998 to an amount of compensation that has not been actually or constructively received and that, pursuant to the terms of the arrangement, is payable in a later year. Therefore, the arrangement provides for the deferral of compensation.

Example 3. (i) Employer O establishes a nonqualified deferred compensation plan (within the meaning of paragraph (b)(1) of this section) for Employee C in 1984. The plan is amended on January 1, 1999 to increase benefits, and the amendment provides that the increase in benefits is on account of Employee C's performance of services for Employer O from 1985 through 1998.

(ii) The additional benefits that resulted from the plan amendment cannot be taken into account as amounts deferred for 1985 through 1998, even though the plan was established before then. Pursuant to paragraphs (b)(2)(ii) and (e)(1) of this section, the additional benefits cannot be taken into account before the latest of the date on which the amendment is adopted, the date on which the amendment is effective, or the date on which the plan, as amended, is set forth in writing.

Example 4. (i) In 1997, Employer P, a state or local government, establishes a plan for certain employees that provides for the deferral of compensation and that is subject to section 457(a).

(ii) Paragraph (b)(1)(i) of this section provides that ''nonqualified deferred compensation plan'' means any plan that is established by an employer and that provides for the deferral of compensation, other than a plan described in section 3121(a)(5). Section 3121(a)(5) lists, among other plans, an exempt governmental deferred compensation plan as defined in section 3121(v)(3). Under section 3121(v)(3)(A), this definition does not include any plan to which section 457(a) applies. Thus, the plan established by Employer P is not an exempt governmental deferred compensation plan described in section 3121(v)(3) and, consequently,is not a plan described in section 3121(a)(5). Accordingly, the plan is a nonqualified deferred compensation plan within the meaning of section 3121(v)(2) and paragraph (b)(1) of this section.

(iii) However, the general timing rule of paragraph (a)(1) of this section and the special timing rule of paragraph (a)(2) of this section apply only to remuneration for ''employment'' that constitutes wages. Under section 3121(b)(7), certain service performed in the employ of a state, or any political subdivision of a state is not ''employment.'' Thus, even though the plan is a nonqualified deferred compensation plan, the extent to which section 3121(v)(2) applies to a participating employee will depend on whether or not the service performed for Employer P is excluded from the definition of employment under section 3121(b)(7).

Example 5. (i) In 1997, Employer Q establishes a plan that provides for bonuses to be paid to employees based on a specified formula that takes into account the employees' performance for the year. The bonus is not actually calculated until March 1 of the following year, and is paid on March 15 of that following year.

(ii) The plan provides for the deferral of compensation because the employees have a legally binding right, as of the last day of a calendar year, to an amount of compensation that has not been actually or constructively received and, pursuant to the terms of the plan, that compensation is payable in a later year. However, because the bonuses under the plan are paid within a brief period of time after the end of the calendar year from which they are deferred, Employer Q may choose, pursuant to paragraph (b)(3)(iii) of this section, to treat the bonuses as if they are not subject to the special timing rule of paragraph (a)(2)(ii) of this section.

Example 6. (i) Employer R establishes a plan under which bonuses based on performance in one year may be paid on February 1 of the following year at the discretion of the board of directors. The board of directors meets in January of each year to determine the amount, if any, of the bonuses to be paid based on performance in the prior year.

(ii) Because an employee does not have a legally binding right to a bonus until January of the year in which the bonus is paid, any bonus paid under the plan in that year will not be considered deferred from the preceding calendar year, and the plan will not be treated as providing for the deferral of compensation within the meaning of paragraph (b)(3)(i) of this section.

Example 7. (i) Employer S maintains a plan for employees that provides nonqualified stock options described in §1.83–7(a) of this chapter. Under the plan, employees are granted in 1997 the option to acquire shares of employer stock at the fair market value of the shares on the date of grant ($50 per share). The options can be exercised at any time from the date of grant through 2006. The options do not have a readily ascertainable fair market value for purposes of section 83 at the date of grant, and shares issued upon the exercise of the options are not subject to a substantial risk of forfeiture within the meaning of section 83. In 2002, when the fair market value of a share of employer stock is $100, Employee D exercises an option to acquire 1,000 shares.

(ii) Under paragraph (b)(4)(ii) of this section, amounts received as a result of a stock option do not result from the deferral of compensation for purposes of section 3121(v)(2). Thus, the $50,000 spread between the amount paid for the shares ($50,000) and the fair market value of the shares on the date of exercise ($100,000) is taken into account as wages for FICA purposes in the year of exercise.

(iii) If the options had been granted at $45 per share, $5 per share below the fair market value on date of grant, the $55,000 spread between the amount paid for the shares ($45,000) and the fair market value of the shares on the date of exercise ($100,000) would similarly be taken into account as wages for FICA purposes in the year of exercise.

Example 8. (i) Employer T establishes a ''phantom stock'' plan for certain employees. Under the plan, an employee is credited on the last day of each calendar year with a dollar amount equal to the fair market value of 1,000 shares of employer stock. Upon termination of employment for any reason, each employee is entitled to receive the value, in cash or employer stock, of the shares with which he or she has been credited.

(ii) Because compensation to which the employee has a legally binding right as of the last day of one year is paid in a subsequent year, the phantom stock plan provides for the deferral of compensation. The phantom stock plan does not provide stock value rights within the meaning of paragraph (b)(4)(ii) of this section because it provides for awards equal in value to the full fair market value of a specified number of shares of Employer T stock, rather than the excess of that fair market value over a specified price.

Example 9. (i) Employer U establishes a plan which provides for payments solely upon an employee's dismissal from employment, death, or disability. The amount of the payments to an employee is based on the length of continuous active service with Employer U at the time of dismissal, and is paid in monthly installments over a period of three years.

(ii) Because benefits payable under the plan upon termination of employment are payable only upon an employee's involuntary termination, the plan is a severance pay plan within the meaning of paragraph (b)(4)(iv) of this section. Thus, the benefits are not treated as resulting from the deferral of compensation for purposes of section 3121(v)(2).

Example 10. (i) On January 1, 1997, Employer V establishes a plan that covers only Employee E, who owns a significant portion of the business and who has 30 years of service as of that date. The plan provides that, upon Employee E's termination of employment at any time, he will receive $200,000 per year for each of the immediately succeeding five years. Employee E terminates employment on March 1, 1997.

(ii) Because Employee E terminates employment within 12 months of the establishment of the plan and the facts and circumstances set forth above indicate that the plan was established in contemplation of impending termination of employment, the plan is considered to be established in connection with impending termination within the meaning of paragraph (b)(4)(v) of this section. Therefore, the benefits provided under the plan are not treated as resulting from the deferral of compensation for purposes of section 3121(v)(2).

Example 11. (i) Employer W establishes a plan on January 1, 1998 to supplement the qualified retirement benefits of recently hired 55-year old Employee F who forfeited retirement benefits with her former employer in order to accept employment with Employer W. The plan provides that Employee F will receive $50,000 per year for life beginning at age 65, regardless of when she terminates employment. On April 15, 1998, Employee F unexpectedly terminates employment.

(ii) The facts and circumstances indicate that the plan was not established in contemplation of impending termination. Thus, even though Employee F terminated employment within 12 months of the establishment of the plan, the plan is not considered to be established in connection with impending termination within the meaning of paragraph (b)(4)(v) of this section. Benefits provided under the plan are treated as resulting from the deferral of compensation for purposes of section 3121(v)(2).

Example 12. (i) Employer X establishes a plan to provide supplemental retirement benefits to a group of management employees who are at various stages of their careers. All employees covered by the plan are subject to the same benefit formula. Employee G is planning to (and actually does) retire within six months of the date on which the plan is established.

(ii) Even though Employee G terminated employment within 12 months of the establishment of the plan, the plan is not considered to have been established in connection with Employee G's impending termination within the meaning of paragraph (b)(4)(v) of this section because the facts and circumstances indicate otherwise.

Example 13. (i) Employee H owns 100 percent of Employer Y, a corporation that provides consulting services. Substantially all of Employer Y's revenue is derived as a result of the services performed by Employee H. In each of 1997, 1998, and 1999, Employer Y has gross receipts of $180,000 and expenses (other than salary) of $80,000. In each of 1997 and 1998, Employer Y pays Employee H a salary of $100,000 for services performed in each of those years. On December 31, 1998, Employer Y establishes a plan to pay Employee H $80,000 in 1999. The plan recites that the payment is in recognition of prior services. In 1999, Employer Y pays Employee H a salary of $20,000 and the $80,000 due under the plan.

(ii) The facts and circumstances described above indicate that the $80,000 paid pursuant to the plan is based on services performed by Employee H in 1999 and, thus, is paid for current services within the meaning of paragraph (b)(4)(viii) of this section. Accordingly, the plan does not provide for the deferral of compensation within the meaning of section 3121(v)(2), and the $80,000 payment is included as wages in 1999 under the general timing rule of paragraph (a)(1) of this section.

(c) *Determination of the amount deferred*—(1) *Account balance plans*—(i) *General rule*. For purposes of this section, if benefits for an employee are provided under a nonqualified deferred compensation plan that is an account balance plan, the ''amount deferred'' for a period equals the principal amount credited to the employee's account for the period, increased or decreased by any income attributable to the principal amount through the date the principal amount is required to be taken into account as wages under paragraph (e) of this section. A nonqualified deferred compensation plan is an account balance plan for purposes of this section only if, under the terms of the plan, a principal amount (or amounts) is credited to an individual account for an employee, the income attributable to each principal amount is credited (or debited) to the individual account, and the benefits payable to the employee are based solely on the balance credited to the individual account. A plan does not fail to be an account balance plan merely because, under the terms of the plan, benefits payable to an employee are based solely on a specified percentage of an account maintained for all (or a portion of) plan participants, under which principal amounts and income are credited (or debited) to such account.

(ii) *Income defined*. For purposes of this section, ''income'' means any increase or decrease in the amount credited to an employee's account that is attributable to amounts previously credited to the employee's account, regardless of whether the plan denominates that increase or decrease as income.

(2) *Nonaccount balance plans*—(i) *General rule*. For purposes of this section, if benefits for an employee are provided under a nonqualified deferred compensation plan that is not an account balance plan (a ''nonaccount balance plan''), the ''amount deferred'' for a period equals the present value of the additional future payment or payments to which the employee has obtained a legally binding right (as described in paragraph (b)(3)(i) of this section) under the plan during that period.

(ii) *Bifurcation permitted*. An employer may treat a portion of a nonaccount balance plan as a separate account balance plan if that portion satisfies the requirements of paragraph (c)(1) of this section and the amount payable to employees under that portion is determined independently of the amount payable under the other portion of the plan.

(iii) *Present value defined*. For purposes of this section, ''present value'' means the value as of a specified date of an amount or series of amounts due thereafter, where each amount is multiplied by the probability that the condition or conditions on which payment of the amount is contingent will be satisfied, and is discounted according to an assumed rate of interest to reflect the time value of money. For purposes of this section, the present value must be determined as of the date the amount deferred is required to be taken into account as wages under paragraph (e)(1) of this section using actuarial assumptions and methods that are reasonable as of that date. For this purpose, a discount for pre-retirement mortality is permitted, but only to the extent that benefits will be forfeited upon death. In addition, the present value cannot be discounted for the risk that payments will not be made (or will be reduced) because of the unfunded status of the plan, the risk associated with any deemed or actual investment of amounts deferred under the plan, the risk that the employer, the trustee, or another party will be unwilling or unable to pay, the possibility of future plan amendments, the possibility of a future change in the law, or similar risks or contingencies.

(3) *Separate determination for each period*. The amount deferred under this paragraph (c) is determined separately for each period for which there is an amount deferred under the plan. In addition, paragraphs (d) and (e) of this section are applied separately with respect to the amount deferred for each such period. Thus, for example, the fraction described in paragraph (d)(1)(ii)(A) of this section and the resolution date amount described in paragraph (e)(4)(ii) of this section are determined separately with respect to each amount deferred.

(4) *Examples*. This paragraph (c) may be illustrated by the following examples:

Example 1. (i) Employer M establishes a nonqualified deferred compensation plan for Employee A. Under the plan, 10 percent of annual compensation is credited on behalf of Employee A on December 31 of each year. In addition, a reasonable rate of interest is credited quarterly on the balance credited to Employee A as of the last day of the preceding quarter. All amounts credited under the plan are 100 percent vested, and the benefits payable to Employee A are based solely on the balance credited to Employee A's account.

(ii) The plan is an account balance plan. Thus, pursuant to paragraph (c)(1) of this section, the amount deferred for a calendar year is equal to 10 percent of annual compensation.

Example 2. (i) Employer N establishes a nonqualified deferred compensation plan for Employee B. Under the plan, 2.5 percent of annual compensation is credited quarterly on behalf of Employee B. In addition, a reasonable rate of interest is credited quarterly on the balance credited to Employee B's account as of the last day of the preceding quarter. All amounts credited under the plan are 100 percent vested, and the benefits payable to Employee B are based solely on the balance credited to Employee B's account. As permitted by paragraph (e)(5) of this section, any amount deferred under the plan for the calendar year is taken into account as wages on the last day of the year.

(ii) The plan is an account balance plan. Thus, pursuant to paragraph (c)(1) of this section, the amount deferred for a calendar year equals 10 percent of annual compensation (*i.e.,* the sum of the principal amounts credited to Employee B's account for the year) plus the interest credited with respect to that 10 percent principal amount through the last day of the calendar year. If Employer N had not chosen to apply paragraph (e)(5) of this section and, thus, had taken into account 2.5 percent of compensation quarterly, the interest credited with respect to those quarterly amounts would not have been treated as part of the amount deferred for the year.

Example 3. (i) Employer O establishes a nonqualified deferred compensation plan for a group of employees. Under the plan, each participating employee has a fully vested right to receive a life annuity, payable monthly beginning at age 65, equal to the product of (a) 2 percent for each year of service and (b) Employee C's highest average annual compensation for a three-year period. The plan also provides that, if Employee C dies before age 65, the present value of the future payments will be paid to his or her beneficiary. As permitted under paragraph (e)(5) of this section, any amount deferred under the plan for a calendar year is taken into account as FICA wages as of the last day of the year. As of December 31, 1998, Employee C has 25 years of service and high three-year average compensation of $100,000 (the average for the years 1996-98). As of December 31, 1999, Employee C is age 61, has 26 years of service, and has high three-year average compensation of $104,000. As of December 31, 2000, Employee C is age 62, has 27 years of service, and has high three-year average compensation of $105,000. The assumptions that Employer O uses to determine the amount deferred for 1999 (a 7 percent interest rate and, for the period after commencement of benefits, the GAM 83 (male) mortality table) and for 2000 (a 7.5 percent interest rate and, for the period after commencement of benefits, the GAM 83 (male) mortality table) are assumed, solely for purposes of this example, to be reasonable actuarial assumptions.

(ii) As of December 31, 1998, Employee C has a legally binding right to receive lifetime payments of $50,000 (2 percent × 25 years × $100,000) per year. As of December 31, 1999, Employee C has a legally binding right to receive lifetime payments of $54,080 (2 percent × 26 years × $104,000) per year. Thus, during 1999, Employee C has earned a legally binding right to additional lifetime payments of $4,080 ($54,080 – $50,000) per year beginning at age 65. The amount deferred for 1999 is the present value, as of December 31, 1999, of these additional payments, which is $27,426 ($4,080 × the present value factor for a deferred annuity payable at age 65, using the specified actuarial assumptions). Similarly, during 2000, Employee C has earned a legally binding right to additional lifetime payments of $2,620 (2 percent × 27 years × $105,000 – $54,080) per year beginning at age 65. The amount deferred for 2000 is the present value, as of December 31, 2000, of these additional payments, which is $18,149 ($2,620 × the present value factor for a deferred annuity payable at age 65, using the specified actuarial assumptions).

(d) *Amounts taken into account and income attributable thereto*—(1) *Taken into account*—(i) *Taken into account defined*. For purposes of this section, an amount deferred under a nonqualified deferred compensation plan is ''taken into account'' as of the date it is included in computing the amount of ''wages'' as defined in section 3121(a), but only to the extent that any additional FICA tax that results from such inclusion (including any interest and penalties for late payment) is actually paid no later than the expiration of the applicable period of limitation for the year in which the amount deferred was required to be taken into account under paragraph (e) of this section. Because an amount deferred for a calendar year is combined with the employee's other wages for the year for purposes of computing FICA taxes with respect to the employee for the year, if the employee has other wages that equal or exceed the wage base limitations for the Old-Age, Survivors, and Disability

Insurance (OASDI) or Hospital Insurance (HI) portions of FICA for the year, no portion of the amount deferred will actually result in additional OASDI or HI tax, respectively. However, because there is no wage base limitation for the HI portion of FICA for years after 1993, the entire amount deferred (in addition to all other wages) is subject to the HI tax for the year and, thus, will not be considered taken into account for purposes of this section unless the HI tax relating to the amount deferred is actually paid. In determining whether any additional FICA tax relating to the amount deferred is actually paid, any FICA tax paid in a year is treated as paid with respect to an amount deferred only after FICA tax is paid on all other wages for the year.

(ii) *Amounts not taken into account*—(A) *Failure to take an amount deferred into account under the special timing rule*. If an amount deferred for a period (as determined under paragraph (c) of this section) is not taken into account, then the nonduplication rule of paragraph (a)(2)(iii) of this section does not apply, and benefits attributable to that amount deferred are included as wages in accordance with the general timing rule of paragraph (a)(1) of this section. For example, if an amount deferred is required to be taken into account in a particular year under paragraph (e) of this section, but the employer fails to pay the additional FICA tax on that amount, then the amount deferred and the income attributable to that amount must be included as wages when actually or constructively paid.

(B) *Failure to take a portion of an amount deferred into account under the special timing rule*. If only a portion of an amount deferred (as determined under paragraph (c) of this section) is taken into account, then a portion of each benefit payment attributable to that amount deferred is excluded from wages pursuant to the nonduplication rule of paragraph (a)(2)(iii) of this section and the balance is subject to the general timing rule of paragraph (a)(1) of this section. The portion that is excluded from wages is fixed when the attributable benefits commence and is determined by multiplying each such payment by a fraction, the numerator of which is the amount that was taken into account (plus income attributable to that amount) and denominator of which is the present value of the future benefit payments attributable to the amount deferred. If the amount deferred was determined using reasonable actuarial assumptions, the present value is determined using those assumptions.

(2) *Income attributable to the amount taken into account*—(i) *Account balance plans*. For purposes of the nonduplication rule of paragraph (a)(2)(iii) of this section, in the case of an account balance plan, the ''income attributable to the amount taken into account'' means any amount credited on behalf of an employee under the terms of the plan that is income (within the meaning of paragraph (c)(1) of this section) attributable to an amount previously taken into account (within the meaning of paragraph (d)(1) of this section), but only if the income is based on a rate of return that does not exceed either the actual rate of return on a predetermined actual investment (whether or not assets associated with the plan or the employer are actually invested therein) or, if no predetermined actual investment has been specified for the period, a reasonable rate of interest. For purposes of this paragraph (d)(2)(i), an actual investment includes an investment identified by reference to any stock index with respect to which there are positions traded on a national securities exchange described in section 1256(g)(7)(A). The actual rate of return includes any decrease as well as any increase in the value of the investment.

(ii) *Nonaccount balance plans*. For purposes of the nonduplication rule of paragraph (a)(2)(iii) of this section, in the case of a nonaccount balance plan, the ''income attributable to the amount taken into account'' means the increase, due solely to the passage of time, in the present value of the future payments to which the employee has obtained a legally binding right, the present value of which constituted the amount taken into account (determined as of the date such amount was taken into account), but only if the amount taken into account was determined using reasonable actuarial assumptions and methods. Thus, each year there will be an increase (determined using the same interest rate used to determine the amount taken into account) resulting from the shortening of the discount period before the future payments are made, plus, if applicable, an increase in the present value resulting from the employee's survivorship during the current year. As a result, if the amount deferred for a period is determined using a reasonable interest rate and other reasonable actuarial assumptions and methods, and the amount is taken into account when required under paragraph (e) of this section, then, under the nonduplication rule of paragraph (a)(2)(iii) of this section, none of the future payments attributable to that amount will be subject to FICA tax when paid.

(iii) *Unreasonable rates of return*—(A) *Account balance plans*. If, under an account balance plan, the rate of interest credited is not reasonable, as determined by the Commissioner, or the rate of return credited otherwise exceeds the applicable limitation in paragraph (d)(2)(i) of this section, then the income attributable to the amount taken into account is limited to the income that would result from application of the mid-term applicable federal rate (as defined pursuant to section 1274(d)) for January 1 of the calendar year, compounded annually (the ''AFR''). However, in the case of a predetermined actual investment, if the actual rate of return on that investment is lower than the AFR, then the income attributable to the amount taken into account is limited to the income that would result from application of that actual rate of return. Any excess of the income credited under the plan over the income determined using the AFR (or, if applicable, the actual rate of return) is considered an additional amount deferred in the year the income is credited, and is required to be taken into account under the special timing rule of paragraph (a)(2) of this section. If the excess is not taken into account as an additional amount deferred in the year credited, then, pursuant to paragraph (d)(1)(ii) of this section, the excess and any income attributable to the excess are subject to the general timing rule of paragraph (a)(1) of this section.

(B) *Nonaccount balance plans*. If any actuarial assumption or method used to determine the amount taken into account under a nonaccount balance plan is not reasonable, as determined by the Commissioner, then the income attributable to the amount taken into account is limited to the income that would result from the application of the AFR and, if applicable, the applicable mortality table under section

417(e)(3)(A)(ii)(I) (the ''417(e) mortality table''), both determined as of the January 1 of the calendar year in which the amount was taken into account. In addition, paragraph (d)(1)(ii)(B) of this section applies and, in calculating the fraction described in that paragraph, the numerator is the amount taken into account plus income (as limited under this paragraph (d)(2)(iii)(B)), and the present value in the denominator is determined using the AFR, the 417(e) mortality table, and reasonable assumptions as to cost of living, each determined as of the time the amount deferred was taken into account.

(3) *Examples*. This paragraph (d) may be illustrated by the following examples:

Example 1. (i) In 1997, Employer M establishes a nonqualified deferred compensation plan for Employee A under which all benefits are 100 percent vested. In 1998, Employee A has $200,000 of current annual compensation from Employer M that is subject to FICA tax. The amount deferred under the plan on behalf of Employee A for 1998 is $20,000. Thus, Employee A has total wages for FICA purposes of $220,000. Because Employee A has other wages that exceed the OASDI wage base for 1998, no additional OASDI tax is owed as a result of the $20,000 amount deferred. Because there is no wage base limitation for the HI portion of FICA, additional HI tax liability results from the $20,000 amount deferred. However, Employer M fails to pay the additional tax.

(ii) Under paragraph (d)(1)(i) of this section, an amount deferred is considered taken into account as wages for FICA purposes as of the date it is included in computing FICA wages, but only if any additional FICA tax liability that results from inclusion of the amount deferred is actually paid. Because the HI tax resulting from the $20,000 amount deferred was not paid, that amount deferred was not taken into account within the meaning of paragraph (d)(1) of this section. Thus, pursuant to paragraph (d)(1)(ii) of this section, benefits attributable to the $20,000 amount deferred will be included as wages in accordance with the general timing rule of paragraph (a)(1) of this section.

Example 2. (i) The facts are the same as in *Example 1*, except that Employer M takes all actions necessary to correct its failure to pay the additional tax before the applicable period of limitation expires for 1998 (including payment of any applicable interest and penalties).

(ii) Because the HI tax resulting from the $20,000 amount deferred is paid, that amount deferred is considered taken into account for 1998. Thus, in accordance with paragraph (a)(2)(iii) of this section, neither the amount deferred nor the income attributable to the amount taken into account will be treated as wages for FICA purposes at any time thereafter.

Example 3. (i) Employer N establishes a nonqualified deferred compensation plan under which all benefits are 100 percent vested. Under the plan, an employee's account is credited with a contribution equal to 10 percent of salary on December 31 of each year. The employee's account balance also is increased each December 31 by ''interest'' on the total amounts credited to the executive's account as of the preceding December 31. The interest rate specified in the plan results in an increase that is not based on the return on a predetermined actual investment within the meaning of paragraph (d)(2)(i) of this section, and that is greater than the increase that would result from application of a reasonable rate of interest within the meaning of paragraph (d)(2)(i) of this section.

(ii) Pursuant to paragraph (d)(2)(iii)(A) of this section, the excess over the AFR is considered an additional amount deferred in the year credited and is required to be taken into account in the year credited.

Example 4. (i) The facts are the same as in *Example 3*, except that the annual increase is based on Moody's Average Corporate Bond Yield.

(ii) Because this index reflects a reasonable rate of interest, it is considered income attributable to the amount taken into account within the meaning of paragraph (d)(2)(i) of this section.

Example 5. (i) The facts are the same as in *Example 3*, except that the annual increase or decrease is equal to the greater of the rate of return on a specified aggressive growth mutual fund or the rate of return on a specified income-oriented mutual fund.

(ii) Because the increase or decrease is based on the greater of the two investment returns and, thus, is not based on the actual rate of return on either specific investment, the increase is not based on the return on a predetermined actual investment within the meaning of paragraph (d)(2)(i) of this section. Thus, if the resulting increase exceeds the AFR, the excess is not considered income attributable to the amount taken into account within the meaning of paragraph (d)(2)(i) of this section and, pursuant to paragraph (d)(2)(iii)(A) of this section, is considered an additional amount deferred.

Example 6. (i) The facts are the same as in *Example 5*, except that the annual increase or decrease with respect to 50 percent of the employee's account is equal to the rate of return on a specified aggressive growth mutual fund and the annual increase or decrease with respect to the other 50 percent of the employee's account is equal to the increase or decrease in the Standard & Poor's 500 Index.

(ii) Because the increase or decrease attributable to any portion of the employee's account is based on the return on a predetermined actual investment, the increase or decrease does not exceed a reasonable rate of return within the meaning of paragraph (d)(2)(i) of this section. Thus, the entire increase or decrease is considered income attributable to the amount taken into account within the meaning of paragraph (d)(2)(i) of this section.

Example 7. (i) The facts are the same as in *Example 3*, except that, pursuant to the terms of the plan, before the beginning of each year, the board of directors of Employer N designates a specific investment on which the following year's annual increase or decrease will be based. The board is authorized to switch investments more frequently on a prospective basis. Before the beginning of 1998, the board designates Company A stock as the investment for 1998. Before the beginning of 1999, the board designates Company B stock as the investment for 1999. At the end of 1999, the board determines that the return on Company B stock was lower than expected and changes its designation for 1999 to a stock that had a higher return during 1999.

(ii) The annual increase or decrease for 1998 is based on the return of a predetermined actual investment. Although the annual increase or decrease for 1999 is based on an actual investment, the actual investment is not predetermined since it was designated after its return was known. In addition, the increase or decrease for 1999 is greater than the actual rate of return on the actual investment that was predetermined. Thus, pursuant to paragraph (d)(2)(iii)(A) of this section, the income attributable to the amount taken into account is limited to the AFR or, if lower, the actual rate of return on the predetermined actual investment that was designated for 1999.

Example 8. (i) Employer O establishes a nonqualified deferred compensation plan for Employee B. Under the plan, if Employee B survives until payment is to be made, he has a fully vested right to receive a lump sum payment at age 65, equal to the product of (a) 10 percent per year of service and (b) Employee B's highest average annual compensation for a three-year period. As permitted under paragraph (e)(5) of this section, any amount deferred under the plan for the calendar year is taken into account as wages as of the last day of the year. As of December 31, 1998, Employee B has 25 years of service and Employee B's high three-year average compensation is $100,000 (the average for the years 1996-98). As of December 31, 1998, Employee B has a legally binding right to receive a payment at age 65 of $250,000 (10 percent × 25 years × $100,000). As of December 31, 1999, Employee B is age 63, has 26 years of service, and has high three-year average compensation of $104,000. As of December 31, 1999, Employer O has a legally binding right to receive a payment at age 65 of $270,400 (10 percent × 26 years × $104,000). Thus, during 1999, Employee B has earned a legally binding right to an additional payment at age 65 of $20,400 ($270,400 – $250,000). The assumptions that Employer O uses to determine the amount deferred for 1999 are a 7 percent interest rate and the GAM 83 (male) mortality table, which, solely for purposes of this example, are assumed to be reasonable actuarial assumptions. The amount deferred for 1999 is the present value, as of December 31, 1999, of the $20,400 payment, which is $17,353. Employer O takes this amount into account by including it in Employee B's FICA wages for 1999 and paying the additional FICA tax.

(ii) Under paragraph (d)(2)(ii) of this section, the income attributable to the amount that was taken into account is the increase in the present value of the future payment due solely to the passage of time, because the amount deferred was determined using reasonable actuarial assumptions and methods. As of the payment date at age 65, the present value of the future payments earned during 1999 is $20,400. The entire difference between the $20,400 and the $17,353 amount deferred ($3,047) is the increase in the present value of the future payment due solely to the passage of time, and thus falls within the definition of ''income attributable to the amount taken into account.'' Because the amount deferred was taken into account, the entire payment of $20,400 represents either an amount deferred that was previously taken into

account ($17,353) or income attributable to that amount ($3,047). Accordingly, pursuant to the nonduplication rule of paragraph (a)(2)(iii) of this section, none of the payment is included in wages.

Example 9. (i) The facts are the same as in *Example 8*, except that, instead of providing a lump sum equal to 10 percent of average compensation per year of service, the plan provides Employee B with a fully vested right to receive a life annuity, payable monthly beginning at age 65, equal to the product of (a) 2 percent for each year of service and (b) Employee B's highest average annual compensation for a three-year period. The plan also provides that, if Employee B dies before age 65, the present value of the future payments will be paid to his or her beneficiary. As of December 31, 1998, Employee B has a legally binding right to receive lifetime payments of $50,000 (2 percent × 25 years × $100,000) per year. As of December 31, 1999, Employee B has a legally binding right to receive lifetime payments of $54,080 (2 percent × 26 years × $104,000) per year. Thus, during 1999, Employee B has earned a legally binding right to additional lifetime payments of $4,080 ($54,080 – $50,000) per year beginning at age 65. The amount deferred for 1999 is the present value, as of December 31, 1999, of these additional payments, determined using reasonable actuarial assumptions and methods. Employer O takes this amount into account by including it in Employee B's FICA wages for 1999 and paying the additional FICA tax.

(ii) Under paragraph (d)(2)(ii) of this section, the income attributable to the amount that was taken into account is the increase in the present value of the future payment due solely to the passage of time, because the amount deferred was determined using reasonable actuarial assumptions and methods. Because the amount deferred was taken into account, the entire benefit stream of $4,080 attributable to the amount deferred in 1999 represents either an amount deferred that was previously taken into account or income attributable to that amount. Accordingly, pursuant to the nonduplication rule of paragraph (a)(2)(iii) of this section, none of the payments are included in wages.

Example 10. (i) The facts are the same as in *Example 9*, except that no amount is taken into account for 1999 because Employer O fails to pay the additional FICA tax.

(ii) Under paragraph (d)(1)(ii)(A) of this section, if an amount deferred for a period is not taken into account, then the benefits attributable to that amount deferred are included as wages in accordance with the general timing rule of paragraph (a)(1) of this section. In this case, assuming that the amounts deferred in other periods were taken into account, $4,080 of each year's total benefit payment will be included in wages when paid.

Example 11. (i) Employer P establishes a nonqualified deferred compensation plan on January 1, 1998 under which all benefits are 100 percent vested. The plan provides that amounts deferred will be credited annually with interest beginning in 1999 at a rate that is greater than a reasonable rate of interest. Pursuant to paragraph (d)(2)(iii)(A) of this section, Employer P treats the excess over the AFR as an additional amount deferred for 1999 and in each year thereafter, and takes the additional amount into account by including it in FICA wages and paying the additional FICA tax for the year.

(ii) Consequently, in accordance with paragraph (a)(2)(iii) of this section, the excess over the AFR and any income (at the AFR) attributable to the excess will not be treated as wages for FICA purposes in any subsequent year.

Example 12. (i) The facts are the same as in *Example 11*, except that Employer P does not treat the excess over the AFR as an additional amount deferred and, accordingly, does not take the excess into account as FICA wages for 1999 and years thereafter.

(ii) Because this excess was not taken into account as an additional amount deferred for 1999 and years thereafter, the excess and any amount attributable to the excess are subject to the general timing rule of paragraph (a)(1) of this section and will be included as wages for FICA purposes when actually or constructively paid.

Example 13. (i) The facts are the same as in *Example 8*, except that, in determining the amount deferred, Employer P uses a 15 percent interest rate, which, solely for purposes of this example, is assumed not to be a reasonable interest rate. Employer P determines that the amount deferred is the present value, as of December 31, 1999, of this payment, which is $15,023. Employer P includes this amount in wages and pays any resulting FICA tax. Assume that the AFR as of January 1, 1999, is 7 percent.

(ii) Under paragraph (d)(2)(iii)(B) of this section, if any actuarial assumption or method is not reasonable, then the income attributable to the amount taken into account is limited to the income that would result from application of the AFR and, if applicable, the 417(e) mortality table. Because the 15 percent interest rate is unreasonable, the income attributable to the amount taken into account is limited to the income that would result from using a 7 percent interest rate and, in this case, an increase for survivorship using the 417(e) mortality table. Under these assumptions, the income attributable to the $15,023 amount deferred is $1,199 in the year 2000 and $1,313 in the year 2001. Under paragraph (d)(1)(ii) of this section, the sum of these amounts ($17,535) is excluded from Employee B's wages pursuant to the nonduplication rule of paragraph (a)(2)(iii) of this section, and the balance of the payment ($2,865) is subject to the general timing rule of paragraph (a)(1) of this section and, thus, is included in Employee B's wages when actually or constructively paid.

(iii) The same result can be reached by multiplying the attributable benefits by a fraction, the numerator of which is the amount taken into account, and the denominator of which is the amount deferred that would have been taken into account at the same time had the amount deferred been calculated using the AFR, the 417(e) mortality table, and a reasonable assumption as to cost of living. All three assumptions are determined as of January 1 of the calendar year in which the amount was taken into account. In this *Example 13*, the fraction would be $15,023 divided by $17,478, which equals .85954. The $20,400 payment is multiplied by this fraction to determine the amount of the payment that is excluded from wages pursuant to the nonduplication rule of paragraph (a)(2)(iii) of this section. Thus, $17,535 ($20,400 × .85954) is excluded from wages and the balance ($2,865) is subject to FICA tax when actually or constructively paid.

Example 14. (i) The facts are the same as *Example 9*, except that Employer O calculates the amount deferred for 1999 as $18,252 and takes that amount into account by including this amount in wages and paying any resulting FICA tax. The assumptions that Employer O uses to determine the amount deferred are a 15 percent interest rate and, for the period after commencement of benefits, the GAM 83 (male) mortality table. The 15 percent interest rate is assumed, solely for purposes of this example, not to be a reasonable actuarial assumption. Assume that the AFR as of January 1, 1999, is 7 percent.

(ii) Under paragraph (d)(2)(iii)(B) of this section, if any actuarial assumption or method used is not reasonable, then the income attributable to the amount taken into account is limited to the income that would result from application of the AFR and, if applicable, the 417(e) mortality table. Because the 15 percent interest rate is not reasonable, the income attributable to the amount taken into account is equal to the income that would result from using a 7 percent interest rate and the amount taken into account is treated as if it represented a portion of the amount deferred for purposes of applying paragraph (d)(1)(ii)(B) of this section. Under these assumptions, the income attributable to the $18,252 amount deferred is $1,278 in the year 2000 and $1,367 in the year 2001. Under paragraph (d)(1)(ii)(B) of this section, the portion of each of benefit payment attributable to the amount deferred that is excluded from wages pursuant to the nonduplication rule of paragraph (a)(2)(iii) of this section is determined at benefit commencement by multiplying each benefit payment by a fraction, the numerator of which is the amount taken into account (plus income attributable to that amount) and the denominator of which is the present value of future benefit payments attributable to the amount deferred. Because the interest rate assumption is not reasonable, not only is the income limited to the application of the AFR, but the present value in the denominator must be determined using the AFR and (if applicable) the 417(e) mortality table. In this case, the present value is $40,283 and thus the fraction is $20,897/$40283, or .51875. Thus, $2,116 (.51875 × $4,080) of each year's benefit payment is excluded from wages and the balance of each year's payment ($1,964) is subject to the general timing rule of paragraph (a)(1) of this section and is included in wages when actually or constructively paid.

(iii) The same result can be reached by multiplying the attributable benefits by a fraction the numerator of which is the amount taken into account, and the denominator of which is the amount deferred that would have been taken into account at the same time had the amount deferred been calculated using the AFR, the 417(e) mortality table, and a reasonable assumption as to cost of living. All three assumptions are determined as of January 1 of the calendar year in which the amount was taken into account. In this *Example 14*, the fraction would be $18,252 divided by $35,165, which equals .51875. The $4,080 annual payment is multiplied by this fraction to determine the amount of the payment that is excluded from wages pursuant to the nonduplication rule of paragraph (a)(2)(iii) of this section. Thus, $2,116 ($4,080 x .51875) is excluded from wages and the balance ($1,964) is subject to FICA tax when actually or constructively paid.

(e) *Time amounts deferred are taken into account*—(1) *In general*. Except as otherwise provided in this paragraph

(e), an amount deferred under a nonqualified deferred compensation plan must be taken into account as wages for FICA purposes as of the later of the date on which services creating the right to the amount deferred are performed (within the meaning of paragraph (e)(2) of this section), or the date on which the right to the amount deferred is no longer subject to a substantial risk of forfeiture (within the meaning of paragraph (e)(3) of this section). However, in no event may any amount deferred under a nonqualified deferred compensation plan be taken into account as wages for FICA purposes prior to the establishment of the plan providing for the amount deferred (or, if later, the plan amendment providing for the amount deferred). Therefore, if an amount is deferred pursuant to the terms of a legally binding agreement that is not put in writing until after the amount would otherwise be taken into account under this paragraph (e)(1), the amount deferred (including any attributable income) must be taken into account as wages for FICA purposes as of the date the plan is put in writing.

(2) *Services creating the right to an amount deferred*. For purposes of this section, services creating the right to an amount deferred under a nonqualified deferred compensation plan are considered to be performed as of the date on which, under the terms of the plan and all the facts and circumstances, the employee has performed all of the services necessary to obtain a legally binding right (as described in paragraph (b)(3)(i) of this section) to the amount deferred.

(3) *Substantial risk of forfeiture*. For purposes of this section, the determination of whether a substantial risk of forfeiture exists must be made in accordance with the principles of section 83 and the regulations thereunder.

(4) *Amount deferred that is not reasonably ascertainable under a nonaccount balance plan*—(i) *In general*. Notwithstanding any other provision of this paragraph (e), an amount deferred under a nonaccount balance plan is not required to be taken into account as wages under the special timing rule of paragraph (a)(2) of this section until the first date on which all of the amount deferred is reasonably ascertainable (the ''resolution date''). In this case, the amount deferred, determined as of the resolution date in accordance with paragraph (c)(2) of this section (the ''resolution date amount''), must be taken into account as of the resolution date. For purposes of this paragraph (e)(4), an amount deferred is considered reasonably ascertainable on the first date on which the only actuarial or other assumptions regarding future events or circumstances needed to determine the amount deferred are interest, mortality, and cost-of-living assumptions. If these assumptions are the only assumptions regarding future events or circumstances that are needed to determine the amount deferred as of a particular date, then the amount deferred will not fail to be reasonably ascertainable merely because the exact amount deferred cannot be readily calculated as of that date.

(ii) *Earlier inclusion permitted*—(A) *In general*. With respect to an amount deferred that is not reasonably ascertainable, an employer may choose to take an amount into account at a date (the ''early inclusion date'') before the resolution date (but not before the date otherwise described in paragraph (e)(1) of this section). If the amount taken into account at the early inclusion date with respect to an amount deferred for a period (plus income attributable to the amount taken into account through the resolution date) is less than the resolution date amount for that period, then the balance of the resolution date amount must be taken into account as of the resolution date. For purposes of determining the income attributable to an amount taken into account as of an early inclusion date, the employer must use an interest rate and, if applicable, a mortality assumption that would have been reasonable as of the early inclusion date.

(B) *Treatment of benefits paid before the resolution date*. If a benefit payment is attributable to an amount deferred that is not reasonably ascertainable at the time of payment, and the employer has previously taken an amount into account with respect to the amount deferred, then, in lieu of the pro rata rule provided in paragraph (d)(1)(ii)(B) of this section, a first-in-first-out rule applies in determining the portion of the payment attributable to the amount taken into account. Under this first-in-first-out rule, the benefit payment is included as wages under the general timing rule of paragraph (a)(1) of this section only to the extent that it exceeds the amount previously taken into account plus income attributable to that amount. However, in determining the additional amount that must be taken into account on the resolution date (under paragraph (e)(4)(ii)(A) of this section), to the extent benefit payments were not included as wages when paid pursuant to the preceding sentence, those payments (plus income attributable to those payments) must be added to the resolution date amount. For purposes of determining the income attributable to such payments, the employer must use an interest rate and, if applicable, a mortality assumption that would have been reasonable as of the early inclusion date.

(5) *Rule of administrative convenience*. For purposes of this section, an employer may treat an amount deferred as required to be taken into account under this paragraph (e) on any date that is later than, but within the same calendar year as, the actual date on which an amount deferred is otherwise required to be taken into account under this paragraph (e). For example, if services creating the right to an amount deferred are considered performed under paragraph (e)(2) of this section periodically throughout a year, the employer may nevertheless treat the services creating the right to that amount deferred as performed on December 31 of that year.

(6) *Portions of an amount deferred required to be taken into account in more than one year*. If different portions of an amount deferred are required to be taken into account under paragraph (e)(1) of this section in more than one year (*e.g.,* on account of a graded vesting schedule), then each such portion is considered a separate amount deferred for purposes of this section.

(7) *Examples*. This paragraph (e) may be illustrated by the following examples:

Example 1. (i) Employer M establishes a nonqualified deferred compensation plan for Employee A on November 1, 1996. Under the plan, which is an account balance plan, Employee A obtains a legally binding right on the last day of each calendar year (if Employee A is employed on that date) to be credited with a principal amount equal to 5 percent of compensation for the year. In addition, a reasonable rate of interest is credited quarterly. Employee A's account balance is nonforfeitable and is payable upon Employee A's termination of employment. For 1997, the principal amount credited to Employee A under the plan (which, in this case, is also the amount deferred within the meaning of paragraph (c) of this section) is $25,000.

(ii) Under paragraph (e)(2) of this section, the services creating the right to the $25,000 amount deferred are considered performed as of December 31, 1997, the date on which Employee A has performed all of the services necessary to obtain a legally binding right to the amount deferred. Thus, in accordance with paragraph (e)(1) of this section, the $25,000 amount deferred must be taken into account as of December 31, 1997, which is the later of the date on which services creating the right to the amount deferred are performed, or the date on which the right to the amount deferred is no longer subject to a substantial risk of forfeiture.

Example 2. (i) The facts are the same as in *Example 1*, except that the principal amount credited under the plan on the last day of each year (and the attributable interest) is forfeited if the employee terminates employment within five years of that date.

(ii) Under paragraph (e)(3) of this section, the determination of whether the right to an amount deferred is subject to a substantial risk of forfeiture is made in accordance with the principles of section 83. Under §1.83–3(c) of this chapter, a substantial risk of forfeiture generally exists where rights in property that are transferred are conditioned, directly or indirectly, upon the future performance of substantial services. Because Employee A's right to receive the $25,000 principal amount (and attributable interest) is conditioned on the performance of services for five years, a substantial risk of forfeiture exists with respect to that amount deferred until December 31, 2002.

(iii) December 31, 2002 is the later of the date on which services creating the right to the amount deferred are performed, or the date on which the right to the amount deferred is no longer subject to a substantial risk of forfeiture. Thus, in accordance with paragraph (e)(1) of this section, the amount deferred (which (pursuant to paragraph (c)(1) of this section) is equal to the $25,000 principal amount credited to Employee A's account on December 31, 1997, plus the interest credited with respect to that principal amount through December 31, 2002) must be taken into account as of December 31, 2002.

Example 3. (i) The facts are the same as in *Example 2*, except that the principal amount credited under the plan on the last day of each year (and the attributable interest) becomes nonforfeitable according to a graded vesting schedule under which 20 percent is vested as of December 31, 1998; 40 percent is vested as of December 31, 1999; 60 percent is vested as of December 31, 2000; 80 percent is vested as of December 31, 2001; and 100 percent is vested as of December 31, 2002. Because these dates are later than the date on which the services creating the right to the amount deferred are considered performed (December 31, 1997), the amount deferred is required to be taken into account as of these dates that fall in five different years.

(ii) Paragraph (e)(6) of this section provides that, if different portions of an amount deferred are required to be taken into account under paragraph (e)(1) of this section in more than one year, then each such portion is considered a separate amount deferred for purposes of this section. Thus, $5,000 of the principal amount, plus interest credited through December 31, 1998, is taken into account as an amount deferred on December 31, 1998; $5,000 of the principal amount, plus interest credited through December 31, 1999, is taken into account as a separate amount deferred on December 31, 1999; etc.

Example 4. (i) In 1997, Employer N establishes a nonqualified deferred compensation plan under which all benefits are 100 percent vested. The plan provides for Employee B (who is age 45) to receive a lump sum benefit of $500,000 at age 65. This benefit will be forfeited if Employee B dies before age 65.

(ii) Because the only assumptions needed to determine the amount deferred are interest and mortality, the amount deferred is reasonably ascertainable within the meaning of paragraph (e)(4)(i) of this section.

Example 5. (i) The facts are the same as in *Example 4*, except that the $500,000 is payable to Employee B at the later of age 55 or termination of employment.

(ii) Because the present value of the future benefit is contingent on when Employee B terminates employment, the determination of the amount deferred requires the use of assumptions other than interest, mortality, and cost-of-living assumptions. Thus, the amount deferred is not reasonably ascertainable within the meaning of paragraph (e)(4)(i) of this section.

Example 6. (i) The facts are the same as in *Example 4*, except that Employee B may elect to take the benefit in the form of a life annuity of $50,000 per year (commencing at age 65) with a present value that is different than the amount payable under the lump sum option.

(ii) Because the present value of the future benefit is contingent on the form of benefit elected by Employee B, the determination of the amount deferred requires the use of assumptions other than interest, mortality, and cost-of-living assumptions. Thus, the amount deferred is not reasonably ascertainable within the meaning of paragraph (e)(4)(i) of this section.

Example 7. (i) Employer O establishes a nonqualified deferred compensation plan. The plan is a supplemental executive retirement plan (SERP) that provides Employee C with a fully vested right to receive a pension, in the form of a straight life annuity payable monthly, beginning at age 65, equal to the excess of (a) 3 percent of Employee C's final three-year average pay for each year of participation up to 15 years, over (b) the amount payable to Employee C from Employer O's qualified pension plan. The amount payable under the qualified pension plan is equal to 1.5 percent of final three-year average pay for each year of employment, excluding pay in excess of the section 401(a)(17) compensation limit. Employee C becomes a participant in the SERP on January 1, 2001, at age 44. As permitted by paragraph (e)(5) of this section, any amount deferred under the SERP for the calendar year is taken into account as wages as of the last day of the year. However, the amount deferred under the SERP for any year is not reasonably ascertainable prior to termination of employment because the determination of such amount requires assumptions other than interest, mortality, and cost-of-living (e.g., an assumption as to Employee C's average pay for the final three years of employment). As permitted by paragraph (e)(4)(i) of this section, Employer O chooses not to take any amount into account for any year before the resolution date. Employee C terminates employment on December 31, 2018.

(ii) As of the date Employee C terminates employment, the only actuarial or other assumptions needed to determine the amount deferred is an interest rate and mortality assumption. At that time, the amount deferred in each past year becomes reasonably ascertainable, and Employer O is able to determine that during 2001 Employee C earned a legally binding right to a life annuity of $4,000 per year. Employer O determines the present value of Employee C's future benefit payments under the SERP as of this resolution date (December 31, 2018), using an 7 percent interest rate and the UP–84 mortality table, which, solely for purposes of this example, are assumed to be reasonable actuarial assumptions for the year 2018. The resulting present value, $ 26,950, is taken into account in accordance with paragraph (d)(1) of this section.

Example 8. (i) The facts are the same as in *Example 7*, except that, as permitted under paragraph (e)(4)(ii) of this section, Employer O chooses to take an amount into account before the amount deferred for each year is reasonably ascertainable. For the year 2001, Employer O chooses to assume that Employee C has earned a legally binding right to a benefit of $1,000 per year from the SERP. Employer O determines the present value of this benefit stream using an 8 percent interest rate and the UP–84 mortality table, which, solely for purposes of this example, are assumed to be reasonable actuarial assumptions for the year 2001. The resulting present value, $1,853, is taken into account for 2001. Employer O does not take any other amount into account before the resolution date.

(ii) In accordance with paragraph (e)(4)(ii)(B) of this section, Employer O determines the additional amount required to be taken into in the year 2008 to be $20,212 (the excess of $26,950 present value of the stream of benefit payments to which Employee C obtained a legally binding right during 2001, determined as of the resolution date, over $6,738 (which is the sum of the $1,853 that was taken into account for 2001, and $4,885 in income attributable to that amount through the resolution date)).

Example 9. (i) The facts are the same as in *Example 8*, except that Employer O determines that Employee C actually had obtained a legally binding right in 2001 to payments under the SERP that have a present value at the 2018 resolution date of $6,000.

(ii) No additional amount is required to be taken into account as of the resolution date. Employer O may claim a refund or credit for the overpayment of FICA tax with respect to amounts taken into account prior to the resolution date to the extent permitted by sections 6402 and 6413.

Example 10. (i) In 1997, Employer P establishes a nonqualified deferred compensation plan for Employee D. The plan provides that, in consideration of Employee D's services to be performed on Project X in 1998, Employee D will receive 1 percent per year of Employer P's net profits associated with Project X for each of the immediately succeeding three years. The 1 percent amount payable for net profits each year will be paid on March 31 of the immediately succeeding year. One percent of net profits associated with Project X is $750,000 in 1999, $400,000 in 2000, and $90,000 in 2001.

(ii) Because the services creating the right to all or the amount deferred are performed in 1998, the benefit payments based on the 1999, 2000, and 2001 net profits are all attributable to the amount deferred in 1998. However, because the present value of D's future benefit is contingent on future profits, the determination of the amount deferred requires the use of assumptions other than interest, mortality, and cost-of-living. Thus, the amount deferred in 1998 will

not be reasonably ascertainable within the meaning of paragraph (e)(4)(i) of this section until December 31, 2001 (which is the resolution date). Employer P does not choose to take any amount into account prior to the amount deferred becoming reasonably ascertainable.

(iii) Paragraph (d)(1)(ii) of this section provides that a benefit attributable to an amount deferred under a nonqualified deferred compensation plan must be included as wages when actually or constructively paid if it is so paid before the amount deferred has been taken into account as wages under the special timing rule of paragraph (a)(2)(ii)of this section. Thus, the benefit payments in 2000 and 2001(on account of 1999 and 2000 net profits) must be included as wages when paid.

(iv) As of December 31, 2001, the amount deferred under the plan becomes reasonably ascertainable. This is because the $90,000 future benefit payment is a knowable quantity, albeit not readily calculable, and the only assumption needed to determine the present value of the future benefits is interest. Thus, the present value of the payment to be made in 2002 is required to be taken into account as of the resolution date (December 31, 2001) under the special timing rule of paragraph (a)(2)(ii) of this section. Using an interest rate of 10 percent per year (which, solely for purposes of this example, is assumed to be reasonable), Employer P determines that the present value of the future benefits is $87,881, and Employer P includes that amount in wages for 2001. (Note that Employer P can choose to use the lag method of withholding described in paragraph (f)(3) of this section, which allows the resolution date amount to be taken into account in the first quarter of 2002, provided that an adjustment for income is made.)

Example 11. (i) The facts are the same as in *Example 10*, except that Employer P chooses the early inclusion option permitted by paragraph (e)(4)(ii) of this section to take $1,000,000 into account on December 31, 1998, before the amount deferred for 1998 is reasonably ascertainable.

(ii) Pursuant to paragraph (e)(4)(ii)(B) of this section, in applying the nonduplication rule of paragraph (a)(2)(iii) of this section, a first-in-first-out rule applies in determining the benefits that are attributable to amounts previously taken into account. Using the 10 percent interest rate, Employer P determines that the $750,000 benefit payment on March 31, 2000, and the March 31, 2001 benefit payment of $400,000 are attributable to the $1,000,000 previously taken into account and, therefore, are not included in wages when paid.

(iii) Under paragraph (e)(4)(ii) of this section, if an employer chooses to take an amount into account before the resolution date, the amount taken into account (plus income attributable to that amount) must be compared with the resolution date amount, and any shortfall must be taken into account as an additional amount deferred as of the resolution date. Pursuant to paragraph (e)(4)(ii)(B) of this section, the benefits paid in 2000 and 2001 that were excluded from wages because they were attributable to the amount that was taken into account (plus income attributable to those payments) must be added to the resolution date amount for purposes of this computation. Thus, Employer P must compare the $1,000,000 taken into account in 1998 (plus income attributable to that amount) to the sum of the $87,881 resolution date amount and the two benefit payments ($750,000 and $400,000) excluded from wages (plus income attributable to each of those benefit payments). Using an interest rate of 10 percent, Employer P determines that the additional amount that is required to be taken into account as of December 31, 2001 is $72,653 ($1,331,000 – ($87,881 + $886,132 + $429,640)).

(f) *Withholding*—(1) *In general*. Unless an employer applies an alternative method described in paragraph (f)(2) or (f)(3) of this section, an amount deferred under a nonqualified deferred compensation plan for any employee is treated, for purposes of withholding and depositing FICA tax, as wages paid by the employer and received by the employee at the time it is taken into account in accordance with paragraph (e) of this section. The alternative methods described in paragraphs (f)(2) and (f)(3) of this section may be used for a calendar year with respect to an amount deferred for an employee only if the amount deferred cannot be readily calculated by the last day of the year. An employer may, from year to year, change between the alternatives described in this paragraph (f).

(2) *Estimated method*—(i) *In general*. Under the alternative method provided in this paragraph (f)(2), the employer may make a reasonable estimate of the amount deferred that cannot be readily calculated and take that estimated amount into account as wages paid by the employer and received by the employee on the last day of the calendar year (the ''first year'').

(ii) *Underestimate of the amount deferred*. If the employer underestimates the amount deferred (as determined after calculating the actual amount deferred that should have been taken into account by the last day of the first year), the employer may treat the shortfall as wages in the first year or in the first quarter of the next year (the ''second year''). In either case, the shortfall does not include the income credited to the amount deferred after the first year. If the employer chooses to treat the shortfall as wages in the first year, the employer must reflect the shortfall on Form W–2 or Form W–2c for the first year, and must correct the information on the Form 941 for the last quarter of the first year. In addition, the shortfall will not be considered a late deposit if it is deposited no later than the employer's first regular deposit date after the close of the first quarter of the second year.

(iii) *Overestimate of the amount deferred*. If the employer overestimates the amount deferred (as determined after calculating the actual amount deferred that should have been taken into account as of the last day of the calendar year) and deposits more than the amount required, the employer may claim a refund or credit in accordance with sections 6402 and 6413.

(3) *Lag method*. Under the alternative method provided in this paragraph (f)(3), the amount deferred that is described in the last sentence of paragraph (f)(1) of this section may be calculated on any date in the first quarter of the succeeding calendar year and treated as wages paid by the employer and received by the employee on that date. For purposes of applying paragraph (c)of this section, the amount deferred includes income attributable to the amount deferred through the date on which that amount is taken into account under this paragraph (f)(3).

(4) *Examples*. This paragraph (f) may be illustrated by the following examples:

Example 1. (i) Employer M maintains a nonqualified deferred compensation plan that is an account balance plan. The plan provides for annual bonuses based on current year profits to be deferred until termination of employment. Employer M's profits for 1998, and thus the amount deferred, cannot be readily calculated until February 15, 1999.

(ii) In accordance with the alternative method described in paragraph (f)(2) of this section, Employer M makes a reasonable estimate that the amount deferred that must be taken into account as of December 31, 1998 for Employee A is $20,000, and withholds and deposits FICA tax on that amount as if it were wages paid by Employer M and received by Employee A on that date. Employer M subsequently determines that the actual amount deferred that should have been taken into account on December 31, 1998 was $22,000.

(iii) In accordance with the alternative method described in paragraph (f)(2)(ii) of this section, Employer M may treat the additional $2,000 as wages paid to and received by Employee A either in 1998 or in the first quarter of 1999. If Employer M chooses to treat the additional $2,000 as wages in 1998, Employer M must pay the FICA tax on the $2,000 difference no later than its first regular deposit date occurring after March 31, 1999. In addition, Employer M must file a Form W–2c for Employee A and must correct the information on Form 941 for the last quarter of 1998. If Employer M complies with these conditions, the FICA tax on the $2,000 difference is not considered a late deposit.

Example 2. (i) The facts are the same as in *Example 1*, except that Employer M subsequently determines that the actual amount deferred that should have been taken into account on December 31, 1998 was $19,000.

(ii) Under paragraph (f)(2)(iii) of this section, Employer M may, in accordance with sections

6402 and 6413, claim a refund or credit for the overpayment of tax resulting from the overestimate.

Example 3. (i) The facts are the same as in *Example 1*, except that Employer M does not make a reasonable estimate of the amount deferred that must be taken into account as of December 31, 1998. Instead, Employer M withholds and deposits FICA tax on the amount deferred plus income on that amount (determined under the terms of the plan) as if it were wages paid by Employer M and received by Employee A on March 15, 1999.

(ii) Under the alternative method described in paragraph (f)(3) of this section, the amount taken into account on March 15, 1999 (including the income) will be treated as wages paid to and received by Employee A in 1999.

(g) *Effective date and transition rules*—(1) *General effective date*—(i) *Effective date*. Except as otherwise provided in this paragraph (g) or in §31.3121(v)–2, this section is effective for amounts deferred and benefits paid on or after January 1, 1997.

(ii) *Reasonable, good faith interpretation*—(A) *in general*. In determining FICA tax liability for amounts deferred and benefits paid before the effective date of this section, an employer may rely on a reasonable, good faith interpretation of section 3121(v)(2), taking into account pre-existing guidance. For example, an employer will be deemed to have determined FICA tax liability and satisfied FICA withholding requirements in accordance with a reasonable, good faith interpretation of section 3121(v)(2) if that liability is determined in accordance with paragraphs (a) through (e) of this section, and the withholding method and timing comply with paragraph (f) of this section. Whether an employer has made a reasonable, good faith interpretation of section 3121(v)(2) will be determined based on the relevant facts and circumstances, including consistency of treatment by the employer.

(B) *Optional adjustment for open years*. If an employer determined FICA tax liability for amounts deferred or benefits actually or constructively paid in any year before the effective date of this section for which the applicable period of limitation has not expired (''pre-effective-date open years''), in a manner that was not in accordance with this section, the employer may adjust its FICA tax determination for that year. In this case, any amount deferred that would have been taken into account (within the meaning of paragraph (d)(1) of this section) in that year under this section must actually be taken into account as if this section were effective for that year. Thus, for example, appropriate adjustments for the prior period must be reflected on Form 941, Employer's Quarterly Federal Tax Return, and Form 941c, Supporting Statement to Correct Information, and Form W–2c must be filed for any affected employee in order that the Social Security Administration may correctly post the amount deferred to the employee's earnings record. Similarly, if an amount was taken into account under a nonaccount balance plan for any pre-effective-date open year, but the amount deferred was not reasonably ascertainable (within the meaning of paragraph (e)(4)(i) of this section), the employer may claim a refund or credit for any FICA tax paid on that amount in accordance with Internal Revenue Code sections 6402 and 6413 and, thereafter, take the amount deferred into account when it first becomes reasonably ascertainable.

(iii) *Plan must be established or adopted*. If amounts are deferred under a plan before the effective date of this section and benefits are paid on or after the effective date of this section, then in no event will an employer's treatment of amounts deferred under the plan be considered to be in accordance with a reasonable, good faith interpretation of section 3121(v)(2) if the employer treats these amounts as taken into account as wages for FICA purposes prior to the establishment of the plan (within the meaning of paragraph (b)(2) of this section) providing for the deferred compensation (or, if later, the plan amendment providing for the deferred compensation). (If all amounts are deferred and all benefits are paid before the effective date of this section, ''adoption'' is substituted for ''establishment'' in the preceding sentence.) For example, awards, bonuses, raises, incentive payments, and other similar amounts granted under a plan as compensation for past services may not be taken into account under section 3121(v)(2) prior to the establishment (or, if applicable, the adoption) of the plan.

(2) *Transition rule for plans that are not subject to section 3121(v)(2)*. If a plan is not a nonqualified deferred compensation plan within the meaning of paragraph (b)(1) of this section, but, for a period prior to the effective date of this section and pursuant to a reasonable, good faith interpretation of section 3121(v)(2)(A), an amount under the plan was taken into account (within the meaning of paragraph (d)(1) of this section) as an amount deferred under a nonqualified deferred compensation plan, then, pursuant to paragraph (g)(1) of this section, the following rules shall apply:

(i) With respect to benefits actually or constructively paid before the effective date of this section that are attributable to amounts previously taken into account under the plan, no additional FICA tax will be owed;

(ii) On or after the effective date of this section, benefits under the plan must be taken into account as wages when actually or constructively paid in accordance with paragraph (a)(1) of this section; and

(iii) To the extent FICA tax was actually paid on the amount taken into account prior to the effective date of this section, the employer may claim a refund or credit to the extent permitted by sections 6402 and 6413. However, if any benefits were actually or constructively paid to an employee under the plan before the effective date of this section and these payments were not subject to FICA tax by reason of the employer's treatment of the plan as a nonqualified deferred compensation plan and the application of paragraph (g)(2)(i) of this section, then the employer may claim a refund or credit for pre-effective-date open years only to the extent that the FICA tax paid on amounts deferred in those years exceeds the FICA tax that would have been owed on the benefits actually or constructively paid to the employee in those years if (notwithstanding paragraph (g)(2)(i) of this section) those benefits had been subject to FICA tax when paid.

(3) *Transition rules for plans that are subject to section 3121(v)(2)*—(i) *Plans that were treated as not subject to section 3121(v)(2) — closed years*. If, for a period prior to the effective date of this section and in accordance with a reasonable, good faith interpretation of section 3121(v)(2), an employer treated a plan as if it were not a nonqualified deferred compensation plan within the meaning of section 3121(v)(2), but that plan is a nonqualified deferred compensation plan within the meaning of paragraph (b)(1) of this section, then, for purposes of determining whether benefits actually

or constructively paid on or after the effective date of this section were previously taken into account as wages for purposes of applying the nonduplication rule of section 3121(v)(2)(B), any amount deferred that would have been required to have been taken into account under this section in a year for which the applicable period of limitation has expired as of the effective date of this section (a ''section 3121(v) closed year'') will be treated as if it had been taken into account within the meaning of paragraph (d)(1) of this section. For purposes of this paragraph (g)(3)(i), an employer will be considered to have treated a plan as if it were not a nonqualified deferred compensation plan for a period prior to the effective date of this section only if the employer withheld and deposited any FICA tax due on any benefits actually or constructively paid under the plan during that period. The rule of this paragraph (g)(3)(i) does not apply to any amount deferred in a year that is not a section 3121(v) closed year that would have been required to have been taken into account under this section (if this section had been in effect for that year). Thus, such an amount deferred will be treated as having been taken into account for purposes of applying the nonduplication rule to benefits paid after the effective date of this section only if the amount deferred was actually taken into account within the meaning of paragraph (d)(1) of this section.

(ii) *Undervaluation of the amount deferred*. If, for a period prior to the effective date of this section, an employer determined the amount deferred for an employee under a nonaccount balance plan in accordance with a reasonable, good faith interpretation of section 3121(v)(2), but that amount is less than the amount that would have been considered the amount deferred under paragraph (c) of this section, the following rules shall apply:

(A) No additional FICA tax will be owed for that period; and

(B) The difference between the amount that was taken into account in a section 3121(v) closed year and the amount that would have been taken into account in that year had the amount deferred been determined under paragraph (c) of this section is treated as if it had been taken into account within the meaning of paragraph (d)(1) of this section. In the case of an amount deferred (in a section 3121(v) closed year) that was not reasonably ascertainable, the difference between the amount taken into account (if any) and the amount that would have been taken into account had the employer taken an amount into account using a method permitted in paragraph (c) of this section and actuarial assumptions that matched the actual experience is treated as if it had been taken into account within the meaning of paragraph (d)(1) of this section. Accordingly, with respect to such an amount deferred, the employer is not required to take any additional amount into account when the amount deferred becomes reasonably ascertainable, and no additional FICA tax will be owed when the benefits attributable to the amount deferred are actually or constructively paid. The rule of this paragraph (g)(3)(ii)(B) does not apply to any amount deferred that would have been required to have been taken into account under this section in a pre-effective-date open year.

(iii) *Overinclusion of the amount deferred*. If an amount deferred for an employee under a nonaccount balance plan was taken into account before the effective date of this section in accordance with a reasonable, good faith interpretation of section 3121(v)(2), but, under this section, that amount would have been taken into account on or after the effective date of this section, the following rules apply:

(A) The determination of an amount deferred for any period beginning on or after the effective date of this section must be made in accordance with paragraph (c) of this section, and the time when that amount deferred is required to be taken into account must be determined in accordance with paragraph (e) of this section, without regard to any amount deferred that was taken into account for any period before the effective date of this section; and

(B) The employer may claim a refund or credit for an overpayment of tax caused by the pre-effective-date overinclusion of wages to the extent permitted by sections 6402 and 6413.

(4) *Examples*. This paragraph (g) may be illustrated by the following examples:

Example 1. (i) In 1994, Employer M establishes a nonqualified deferred compensation plan that is a nonaccount balance plan for Employee A. All benefits under the plan are 100 percent vested. In order to determine the amount deferred on behalf of Employee A under the plan for 1994 and 1995, Employer M must make assumptions as to the date on which Employee A will retire and the form of benefit Employee A will elect, in addition to interest, mortality, and cost-of-living assumptions. Based on assumptions made with respect to all of these contingencies, Employer M determines that the amount deferred for 1994 is $50,000 and the amount deferred for 1995 is $55,000. No OASDI tax is owed with respect to those amounts deferred. However, Employer M withholds and deposits HI tax on those amounts. Because Employee B does not retire before the effective date of this section, Employer R will still need to make assumptions for the date of retirement and the form of benefit through the effective date. Employer M chooses to apply this section before its effective date to 1994 and 1995.

(ii) Under the regulations in this section, the amounts deferred in 1994 and 1995 are not reasonably ascertainable (within the meaning of paragraph (e)(4)(i) of this section) before the effective date of this section. Thus, assuming the applicable period of limitation has not expired for 1994 and 1995, Employer M may, in accordance with paragraph (g)(1)(ii)(B) of this section, apply for a refund or credit for the HI tax paid on the amounts deferred for 1994 and 1995 in accordance with sections 6402 and 6413 and, in accordance with paragraph (e)(4) of this section, take into account the amounts deferred when they become reasonably ascertainable.

Example 2. (i) Employer N adopts a plan on January 1, 1994 that covers Employee B, who has 10 years of service as of that date. The plan provides that, in consideration of Employee B's outstanding services over the past 10 years, Employee B will be paid a $500,000 lump sum distribution upon termination of employment at any time. On January 15, 1996, Employee B terminates employment with Employer N. Employer N determines, based on a reasonable, good faith interpretation of section 3121(v)(2), that the plan is a nonqualified deferred compensation plan under that section. Employer N treats the $500,000 as having been taken into account as an amount deferred in 1993 and earlier years.

(ii) Under paragraph (g)(1)(iii) of this section, if all amounts are deferred and all benefits are paid under a plan before the effective date of this section, then in no event will an employer's treatment of amounts deferred under the plan be considered to be in accordance with a reasonable, good faith interpretation of section 3121(v)(2) if the employer treats these amounts as taken into account as wages for FICA purposes prior to the adoption of the plan. Accordingly, Employer N's treatment is not in accordance with a reasonable, good faith interpretation of section 3121(v)(2) because Employer N treated amounts as taken into account in years before the adoption of the plan.

Example 3. (i) Employer O adopts a bonus plan on December 1, 1993 that becomes effective and legally binding on January 1, 1994. Under the plan, which is not set forth in writing, a specified bonus amount (which is 100 percent vested) is credited to Employee C's account each December 31. A reasonable rate of interest on Employee C's account balance is credited quarterly. Employee C's account balance will begin to be paid in equal annual installments over ten years beginning on January 1, 1999. Employer O determines, based on a reasonable, good faith

interpretation of section 3121(v)(2), that the bonus plan is a nonqualified deferred compensation plan under that section and, therefore, treats the amounts credited on December 31, 1994, 1995, and 1996 as amounts deferred and takes those amounts deferred into account as wages for FICA purposes as of those dates. The bonus plan is set forth in writing on February 1, 1997, which for purposes of this example is assumed to be prior to the date that is six months after the publication of the final regulations, and, thus, is treated as established as of January 1, 1994.

(ii) Under paragraph (g)(1)(iii) of this section, if all amounts are deferred and all benefits are paid under a plan before the effective date of this section, then in no event will an employer's treatment of amounts deferred under the plan be considered to be in accordance with a reasonable, good faith interpretation of section 3121(v)(2) if the employer treats these amounts as taken into account as wages for FICA purposes prior to the establishment of the plan (within the meaning of paragraph (b)(2) of this section. Because the bonus plan is treated as established on January 1, 1994 (pursuant to the transition rule provided in paragraph (b)(2)(iii) of this section), the amounts deferred are not treated as having been taken into account prior to the establishment of the plan, even though the plan was not set forth in writing until February 1, 1997.

Example 4. (i) In 1985, Employer P establishes a compensation arrangement for Employee D that provides annual payments over a number of years after termination of employment. Prior to the effective date of this section, and in accordance with a reasonable, good faith interpretation of section 3121(v)(2), Employer P treats the arrangement as a nonqualified deferred compensation plan under section 3121(v)(2). Each year, consistent with this treatment, Employer P determines the amount deferred that must be taken into account as FICA wages for the year. Employer P also determines that Employee D's total wages (without regard to the amount deferred) for each year from 1985 through 1993 exceed the applicable wage base for each of those years and, consequently, there is no FICA tax liability with respect to the amounts deferred for those years. In 1994, Employee D's total wages (without regard to the amount deferred) exceed the OASDI wage base. However, because there is no limit on the HI wage base, the amount deferred for 1994 results in additional HI tax liability of $290, which is timely paid by Employer P.

(ii) Employee D terminates employment with Employer P in 1995 and receives a plan payment of $50,000. In that year, Employee D also receives wages of $60,000 from Employer P. In accordance with its treatment of the plan as a nonqualified deferred compensation plan under section 3121(v)(2), Employer P does not treat the payment in 1995 as wages for FICA purposes in that year. Although Employer P made a reasonable, good faith determination that the plan is a nonqualified deferred compensation plan under section 3121(v)(2), the plan is not a nonqualified deferred compensation plan within the meaning of paragraph (b)(1) of this section. Both 1994 and 1995 are pre-effective-date open years.

(iii) Because amounts under a plan were taken into account (within the meaning of paragraph (d)(1) of this section) as amounts deferred under a nonqualified deferred compensation plan pursuant to a reasonable, good faith interpretation of section 3121(v)(2)(A), but that plan is not a nonqualified deferred compensation plan within the meaning of paragraph (b)(1) of this section, the transition rule provided in paragraph (g)(2) of this section applies. Thus, no additional FICA tax will be owed on benefits paid in 1995. However, on or after the effective date of this section, benefits under the plan must be taken into account as wages when actually or constructively paid in accordance with the general timing rule of paragraph (a)(1) of this section.

(iv) Because $290 of HI tax was paid on the amount deferred in 1994, Employer P is entitled to a refund or credit for that amount – but only to the extent that $290 exceeds the FICA tax that would have been owed on the $50,000 annual payment in 1995 if those benefits had been subject to FICA tax when paid (i.e., if the regulation had been effective for those years). In 1995, Employee D had other wages of $60,000. Thus, only $1,200 (the $61,200 OASDI wage base, less the $60,000 of other wages) of the $50,000 payment would have been subject to OASDI; the full $50,000 would have been subject to HI. This would have resulted in $148.80 of OASDI tax ($1,200 × 12.4 percent) and $1,450 of HI tax ($50,000 × 2.9 percent). Employer P is not entitled to a refund or credit under the transition rule of paragraph (g)(2) because the $290 of HI tax paid in 1994 is less than the total $1,598.80 of FICA tax liability that would have resulted if this section had applied for 1995.

Example 5. (i) In 1985, Employer Q establishes a compensation arrangement for Employee E that is a nonqualified deferred compensation plan within the meaning of paragraph (b)(1) of this section. However, prior to the effective date of this section, Employer Q determines, based on a reasonable, good faith interpretation of section 3121(v)(2), that the arrangement is not a nonqualified deferred compensation plan within the meaning of that section. Thus, when payments under the arrangement begin in 1995, Employer Q withholds and deposits FICA tax on the amounts paid to Employee E. Payments under the arrangement continue after the effective date of this section. Employer Q does not choose (under paragraph (g)(1)(ii)(B) of this section) to adjust its FICA tax determination for pre-effective-date open years by treating this section as in effect for all amounts deferred and benefits actually or constructively paid for those years.

(ii) Under paragraph (g)(3)(i) of this section, for purposes of determining whether benefits actually or constructively paid on or after the effective date of this section were previously taken into account for purposes of applying the nonduplication rule of section 3121(v)(2)(B), any amount that would have been required to have been taken into account in a section 3121(v) closed year will be treated as if it had been taken into account within the meaning of paragraph (d)(1) of this section. Under the nonduplication rule, benefits attributable to an amount that has been so taken into account is not treated as wages for FICA purposes at any later time (such as upon payment).

(iii) Because Employer Q does not adjust its FICA tax determination for pre-effective-date open years by treating this section as in effect for all amounts deferred for those years, any benefits attributable to those amounts will be included in wages when actually or constructively paid in accordance with the general timing rule of paragraph (a)(1) of this section.

Example 6. (i) The facts are the same as in *Example 5*, except that Employer Q chooses (in accordance with paragraph (g)(1)(ii)(B) of this section) to adjust its FICA tax determination for all pre-effective-date open years by treating this section as in effect for all amounts deferred for those years.

(ii) In accordance with the nonduplication rule of paragraph (a)(2)(iii) of this section, any benefits attributable to the amounts deferred that were taken into account for pre-effective-date open years in accordance with paragraph (d)(1) of this section will not be included as wages when actually or constructively paid.

Example 7. (i) The facts are the same as in *Example 5*, except that Employer Q does not withhold and deposit the FICA tax due on benefits actually or constructively paid prior to the effective date of this section.

(ii) Because Employer Q did not withhold and deposit the FICA tax due on benefits actually or constructively paid during that period, the transition rule provided in paragraph (g)(3)(i) of this section does not apply. Therefore, any amount that would have been required to have been taken into account under this section in a pre-effective-date closed year is not treated as if it had been so taken into account, and benefits attributable to any such amount are treated as FICA wages when actually or constructively paid in accordance with the general timing rule of paragraph (a)(1) of this section.

Example 8. (i) In 1993, Employer R establishes a nonqualified deferred compensation plan for Employee F. In accordance with a reasonable, good faith interpretation of section 3121(v)(2), Employer R determines that, for 1993, there is an amount deferred of $2.5 million that must be taken into account as wages for FICA purposes. However, because Employee F has other wages in 1993 that exceed the applicable OASDI and HI wage bases for that year, no additional FICA tax is actually owed as a result of that amount deferred being taken into account for 1993. Under this section, $2 million of the amount taken into account in 1993 would have been taken into account for years beginning on or after the effective date of this section because Employee F did not have a legally binding right to that amount until after that date.

(ii) In accordance with paragraph (g)(3)(iii)(A) of this section, the determination of the amount deferred under the plan for any period beginning on or after the effective date of this section must be made in accordance with paragraph (c) of this section, and the time when that amount deferred is required to be taken into account must be determined in accordance with paragraph (e) of this section. In addition, these determinations must be made without regard to any amount deferred that was taken into account for any period before the effective date of this section. Thus, the $2 million that, under this section, would have been taken into account for years beginning on or after the effective date of this section must be taken into account under this section for those years. Because no FICA tax was actually paid on that $2 million in 1993, no overpayment of tax was caused by the overinclusion of wages in 1993 and, thus, Employer R is not entitled to a refund or credit.

§ 31.3121(v)(2)–2 Effective dates and transition rules.

(a) *General effective date*. Except as otherwise provided in paragraphs (b)

through (e) of this section, section 3121(v)(2) and the amendments made to section 3121(a)(2), (3), and (13) by the Social Security Amendments of 1983 (Pub. L. 98–21, 97 Stat. 65 (1983)), as amended by section 2662(f)(2) of the Deficit Reduction Act of 1984 (Pub. L. 98–369, 98 Stat. 494 (1984)), apply to amounts deferred and benefits paid after December 31, 1983.

(b) *Definitions*. For purposes of §31.3121(v)(2)–1 and paragraphs (a) through (e) of this section, the following definitions apply:

FICA. FICA means the Federal Insurance Contributions Act (26 U.S.C. § 3101 et seq.).

457(a) plan. A 457(a) plan means an eligible deferred compensation plan of a State or local government or of a tax-exempt organization to which section 457(a) of the Internal Revenue Code applies.

Gap agreement. Gap agreement means an agreement adopted after March 24, 1983, and on or before December 31, 1983.

March 24, 1983 agreement. March 24, 1983 agreement means an agreement in existence on March 24, 1983 between an individual and a nonqualified deferred compensation plan within the meaning of §31.3121(v)–1(b). For this purpose only, any plan (or agreement) to make payments that qualify for one of the retirement payment exclusions is treated as a nonqualified deferred compensation plan, regardless of whether the plan (or agreement) is treated as a nonqualified deferred compensation plan within the meaning of §31.3121(v)–1(b). For example, §31.3121(v)–1(b)(4)(v) provides that certain benefits established in connection with impending termination do not result from the deferral of compensation and thus are not considered deferred under a nonqualified deferred compensation plan. However, a plan that provides such benefits and that was in existence on March 24, 1983 is treated as a nonqualified deferred compensation plan for purposes of this paragraph (b) to the extent it provides benefits that would have satisfied one of the retirement payment exclusions had the benefits been paid on April 19, 1983.

Post-amendment. Post-amendment means after December 31, 1983.

Pre-amendment. Pre-amendment means on or before December 31, 1983.

Retirement payment exclusions. Retirement payment exclusions are the exclusions from wages (for FICA tax purposes) for retirement payments under sections 3121(a)(2)(A), (a)(3), and (a)(13)(A)(iii), as in effect on April 19, 1983.

Transition benefits. Transition benefits are post-amendment payments attributable to pre-amendment services.

(c) *Transition rules*—(1) *In general*. The general effective date described in paragraph (a) of this section applies to post-amendment payments attributable solely to post-amendment services, whether or not paid under a March 24, 1983 agreement or a gap agreement. Thus, section 3121(v)(2) applies, and the retirement payment exclusions do not apply, to these benefits. Special effective dates apply to transition benefits under a March 24, 1983 agreement and transition benefits under a gap agreement. These special effective dates are set forth in paragraphs (c)(2) and (c)(3) of this section, respectively.

(2) *Transition benefits under a March 24, 1983 agreement*. Transition benefits under a March 24, 1983 agreement (except for those under a 457(a) plan) are not subject to the special timing rule of section 3121(v)(2) and remain subject to section 3121(a) as in effect on April 19, 1983. Thus, transition benefits under a March 24, 1983 agreement (except for those under a 457(a) plan) are excluded from wages (for FICA tax purposes) only if they qualify for any of the retirement payment exclusions (or any other exclusion provided under section 3121(a) as in effect on April 19, 1983).

(3) *Transition benefits under a gap agreement*. The payor of transition benefits under a gap agreement must choose to either—

(i) Take the transition benefits into account as wages when paid; or

(ii) Take the amount deferred (within the meaning of §31.3121(v)–1(c)) with respect to the transition benefits into account as wages under section 3121(v)(2) (as if section 3121(v)(2) had applied before its general effective date).

(d) *Determining transition benefit portion*. For purposes of determining the portion of total benefits under a nonqualified deferred compensation plan that represents transition benefits, if, under the terms of the plan, benefits are not attributed to specific years of service, the employer may use any reasonable method. For example, if a plan provides that the employee will receive benefits equal to two percent of high three-year average compensation multiplied by years of service, and the employee retires after 25 years of service, nine of which are before 1984, the employer may determine that 9/25 of the total benefits to be received beginning in 2000 are transition benefits attributable to services performed before 1984.

(e) *Order of payment*. If an employer determines, in accordance with paragraph (d) of this section, that a portion of the total benefits under a nonqualified deferred compensation plan constitutes transition benefits, then, for purposes of determining the portion of each benefit payment that constitutes transition benefits—

(1) For a payment made before the effective date of this section, the employer may use any reasonable allocation method to determine the portion of a payment that consists of transition benefits, provided that the allocation method is consistent with the terms of the plan; and

(2) For a payment made on or after the effective date of this section, the employer must treat each payment as consisting of transition benefits in the same proportion as the transition benefits that have not been paid (as of the effective date of this section) bear to total benefits that have not been paid (as of the effective date of this section), unless such allocation is inconsistent with the terms of the plan.

Margaret Milner Richardson,
Commissioner of Internal Revenue.

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TEST OF EMPLOYMENT TAX EARLY REFERRAL PROCEDURES FOR APPEALS

Announcement 96–13

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SECTION. 6. RESOLVING THE EARLY REFERRAL ISSUE(S)

.01 In general
.02 Agreement reached
.03 Agreement not reached

SECTION. 7. NO USER FEE

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SECTION 1. SUMMARY

Early referral procedures were published in Rev. Proc. 96–9, 1996–2 I.R.B. 15. This Announcement applies the provisions of the revenue procedure to employment tax issues, as described below, on a one-year test basis.

Taxpayers whose returns are being examined can request early referral of one or more employment tax issue(s) from district compliance functions (''the District'') to Appeals. Early referral of the employment tax issue(s) does not alter the District Director's authority to audit the returns of a taxpayer nor limit or expand the District Director's authority to resolve any issues, including the authority in Delegation Order No. 236, 1991–1 C.B. 313.

These procedures are effective for requests for early referral made during the one-year test period beginning on March 18, 1996, the date this announcement is published in the Internal Revenue Bulletin.

SECTION 2. PURPOSE and SCOPE

.01 In general. This Announcement is part of the Internal Revenue Service's strategy designed to improve employment tax administration for all taxpayers, including those who are small business owners. The purpose of early referral for employment tax issues is to resolve them more expeditiously through simultaneous action by the District and Appeals. This Announcement describes the method by which a taxpayer requests early referral of one or more unagreed employment tax issues from the District to Appeals. A taxpayer may request early referral of any developed, unagreed employment tax issue that is under the jurisdiction of the District Director arising from an audit. The District will continue to develop other issues arising in the audit.

Early referral for employment tax issues is:

- optional;
- initiated by the taxpayer;
- subject to the approval of both the District Director and the Assistant Regional Director of Appeals (ARDA); and
- not limited to Coordinated Examination Program (CEP) taxpayers.

.02 APPROPRIATE ISSUES FOR EARLY REFERRAL. Appropriate issues for early referral include those that if resolved can reasonably be expected to result in a quicker resolution of the entire case; and that both the taxpayer and District Director agree should be referred to Appeals early. Therefore, early referral may not be available for every employment tax issue.

Examples of appropriate employment tax issues for early referral include:

1) Worker Classification Issues, including whether a worker is an employee or independent contractor under the common law; whether a worker is a statutory employee or statutory non-employee; whether Section 530 of the Revenue Act of 1978 applies; whether I.R.C. § 3509 rates are appropriate; and whether the taxpayer qualifies for an interest-free adjustment.

2) Other Issues, including whether certain payments are excepted from the definition of ''wages'' (*e.g.,* a fringe benefit that would be excludable from the employee's gross income under I.R.C. § 132); and whether certain services are excepted from the definition of ''employment.''

Because taxes under the Self-Employment Contributions Act (I.R.C. §§ 1401–1403) are income taxes, rather than employment taxes, issues arising under these sections are not included in this early referral procedure.

SECTION 3. HOW TO REQUEST EARLY REFERRAL

An early referral request must follow the requirements set forth in section 3, **Procedures For Requesting Early Referral**, in Rev. Proc. 96–9. A request for early referral must be submitted in writing by the taxpayer to the case manager. The case manager may suggest that a taxpayer make such a request. For purposes of this announcement, ''case manager'' includes Compliance, Examination, Collection, and EP/EO group managers. See section 3.02 regarding **Statement of Issues and Position**; section 3.03, **Perjury Statement**; and section 3.04, **Signatures.**

SECTION 4. PROCESSING AN EARLY REFERRAL REQUEST

An early referral request will be processed in the manner described in section 4 of Rev. Proc. 96–9, **Processing An Early Referral Request.** Included in section 4 are: section 4.01, **Approving or Denying the Request for Early Referral**; section 4.02, **Notification of Action**; and section 4.03, **No Appeal.**

SECTION 5. TRANSFERRING THE ISSUE FROM THE DISTRICT TO APPEALS

.01 In general. If an issue is approved for transfer from the District to Appeals, the procedures described in section 5 of Rev. Proc. 96–9 generally will apply. The following specifically apply to employment tax issues:

.02 The District issues an employment tax report. The District will prepare an employment tax report for each approved early referral issue. The report must identify the amount of employment tax(es) in dispute; fully describe the issue(s); and explain the District's position. This report will be sent to the taxpayer.

.03 Taxpayer response to District's report. The taxpayer must respond in writing to the District's report. The response must contain an explanation of the taxpayer's position regarding the issue(s), similar to that which would be provided in an Appeals protest, and

satisfy the declaration and signature requirements in sections 3.03 and 3.04 of Rev. Proc. 96–9.

The taxpayer's response must be submitted to the case manager within 30 days of the date of the report. This 30-day requirement may be extended by the case manager. If the taxpayer's response with respect to an issue is not received within the time provided, the taxpayer's early referral request will be considered withdrawn regarding that particular issue(s) without prejudice to the taxpayer's right to an administrative appeal at a later date. But see section 8 of Rev. Proc. 96–9, **Withdrawal from the Early Referral Process**, regarding withdrawal after Appeals has taken jurisdiction over the early referral issue(s).

.04 Early referral file sent to Appeals. After the taxpayer has responded in writing to the report, the District compliance function will send the early referral file to Appeals. The file should include copies of:

- applicable portions of tax returns and workpapers;
- the approved early referral request;
- the District's report;
- the taxpayer's written response to the report; and
- the District's response to the taxpayer's position, if any.

Appeals has jurisdiction over the issue(s) accepted for early referral. All other issues in the case remain in the District's jurisdiction.

SECTION 6. RESOLVING THE EARLY REFERRAL ISSUE(S)

.01 In general. The taxpayer's written response to the District's report generally serves the same purpose as an Appeals protest. Established Appeals procedures, including those governing submissions and taxpayer conferences, apply to early referral issues. See § 601.106 *et seq.* of the Statement of Procedural Rules. See generally section 6 of Rev. Proc. 96–9. The following specifically apply to early referral of employment tax issues:

.02 If agreement of the early referral issue(s) is reached. If an agreement is reached with respect to an early referral issue(s), an agreement Form 2504 or 2504 AD, labelled ''Partial Agreement,'' may be used for factual or non-complex issues that have no features that affect subsequent years. A closing agreement generally will be prepared for issues where a settlement is complex or affects subsequent years. See I.R.C. § 7121 and also Rev. Proc. 68–16, 1968–1 C.B. 770, which describes the preparation of closing agreements. Appeals will coordinate effects on subsequent years with the District and District Counsel.

.03 If agreement of the early referral issue(s) is not reached. If an agreement is not reached with respect to an early referral issue(s), see section 6.03 of Rev. Proc. 96–9, **Agreement Not Reached**. See also generally, section 7, of Rev. Proc. 96–9, **Effect of Conclusion of Examination**. The following specifically apply to early referral of employment tax issues: If no issues in the case remain unagreed except for an early referral employment tax issue that could not be settled by Appeals and has been returned to the District, no 30-day letter will be issued. Rather, the District will process the case for assessment of tax due from the taxpayer.

SECTION 7. NO USER FEE

There is no user fee for an early referral employment tax request.

SECTION 8. EFFECTIVE DATE

These procedures are effective for requests for early referral made during the one-year test period beginning on March 18, 1996, the date this announcement is published in the Internal Revenue Bulletin.

DRAFTING INFORMATION

The principal author of this announcement is Thomas C. Louthan, Director, Office of Dispute Resolution & Specialty Programs, National Office Appeals. For further information regarding this announcement, please contact Mr. Louthan at (202) 401-4098 (not a toll-free number).

Foundations Status of Certain Organizations

Announcement 96–14

The following organizations have failed to establish or have been unable to maintain their status as public charities or as operating foundations. Accordingly, grantors and contributors may not, after this date, rely on previous rulings or designations in the Cumulative List of Organizations (Publication 78), or on the presumption arising from the filing of notices under section 508(b) of the Code. This listing does *not* indicate that the organizations have lost their status as organizations described in section 501(c)(3), eligible to receive deductible contributions.

Former Public Charities. The following organizations (which have been treated as organizations that are not private foundations described in section 509(a) of the Code) are now classified as private foundations:

Academic Boosters of Breathitt County, Jackson, KY
AIDS Research Foundation Inc., Toms River, NJ
Akron Youthquake Ministries Inc., Akron, OH
Alexandria Band Boosters Inc., Alexandria, IN
Arlington Elder Care Corp., Arlington, VA
Asbury Male Youth Project Inc., Washington, DC
Association for Americans Outdoors Inc., Bloomington, IN
Atlantic Reef Builders Inc., Margate, NJ
Berkeley County Schools Foundation, Inc., Martinsburg, WV
Biblical Institute for Social Change, Washington, DC
Black Hills Citizens for a Better Community, Grand Rapids, MI
Black Managers Association Inc., Indianapolis, IN
Brunswick Housing Development Corp., Medina, OH
Bryan Elementary Parent Teacher Organization, Bryan, OH
Campbell Lodge a Home for Boys Alumni Association Inc., Park Hills, KY
Carolyn Steinhoff Smith, Inc., Tulsa, OK
Center Grove High School Choir, Greenwood, IN
Center School Association, Mayfield Village, OH
Charles W. Bissinger & Associates Inc., Arnold, MD
Childrens Hospice of New Jersey Inc., Union, NJ

Choice Recovery Center Inc., Circleville, OH
Chrysalis Inc., Flint, MI
Class of 2000 Inc., Freehold, NJ
Clergy Coalition Against Crack Cocaine, Saginaw, MI
Clio Area Bank Boosters Association Inc., Clio, MI
Community Foundation of Greater Johnstown, Johnstown, PA
Community Health Centers of Laredo, Inc., Lardeo, TX
Concerned Citizens of Alderson-Glen Ray Inc., Lewisburg, WV
Construction Trades Training and Advancement Program, Charleston, WV
Crisis Counseling Center Inc., Lebanon, OH
Cumberland County 4-H FDN Inc., Fayetteville, NC
Damascus Development Corporation, Baltimore, MD
Day Springs Mature Care Inc., Norwalk, OH
David Verbance Heart Transplant Fund Assoc., Columbus, OH
Delaware Family Foundation Inc., Wilmington, DE
Encouragement Place Institute, The, Duncansville, PA
Erlanger Historical Society Inc., Erlanger, KY
Eye Opener Inc., Baltimore, MD
Factory Street Studio & Moving Parts, Inc., Athens, OH
Fathers United of Indiana Inc., Highland, IN
Fayette Area Community Concert Assoc., Washington, OH
Foundation for Skeletal Health Research, Yellow Sorings, OH
Friends of Catholic Education Inc., Walkersville, MD
Friends of Chimes International Inc., Baltimore, MD
Friends of Community Mental Health and Counseling Center, Hermitage, PA
Friends of the Friendless, Inc., Bronx, NY
Friends of the Outside Transportation Program, Denver, CO
Gathering Center, The, Columbus, OH
Great Waters Aquarium, Broadview Heights, OH
Gum Springs Community Development Foundation Inc., Alexandria, VA
H.O.P.E. Inc., Gary, IN
Hunter Institute, Northbrook, IL
India Association of Lehigh Valley, The, Lehigh Valley, PA
India Classical Dance Society, McLean, VA
Indiana Opera North Inc., South Bend, IN
Indy Inferno Soccer Club, Greenwood, IN
Infinity Film Productions, Philadelphia, PA
Institute for Global Action, Norton, OH
Inter Community Reality Corporation, Norristown, PA
JMC Leukemia Foundation Inc., The, Brielle, NJ
Kids Corporation, Williamsburg, VA
Korean American Food Dealers Association of Greater Washington, The, Washington, DC
Leukemia Fund Raising Society, Waterford, MI
Magic Flute Productions Inc., St. Louis, MO
Mantua Against Drugs Inc., Philadelphia, PA
Mantua Haverford Community Center, Philadelphia, PA
Marie-Stephen Inc., McKeesport, PA
Mayfield Middle School Assoc., Mayfield Heights, OH
Mid Atlantic Association for the Education of Young Children, Wilmington, DE
Mill Creek Jazz and Cultural Society Inc., Philadelphia, PA
Monday Night Musicales, Washington, DC
Nansemond-Suffolk Academy Band Parents Association, Suffolk, VA
National Remodeling Foundation, Arlington, VA
Nehemiah Neighborhood Development Corporation, Dayton, OH
Newaygo Public Schools Educational Advancement Foundation, Newaygo, MI
New Cumberland Library and Cultural Foundation, New Cumberland, PA
New Futures for Dayton Area Youth Inc., Dayton, OH
Nightline Inc., Dearborn, MI
North Carolina Foundation for International Commerce, Research Triangle Park, NC
North East Community Foundation, North East, PA
Northwest Passage Arts Center, Philadelphia, PA
Olympia New Jersey Inc., Trenton, NJ
Operation Something from Home Corp., Manassas, VA
Organge Schools Educational Foundation, Pepper Pike, OH
Otto W. Haisley School Parent-Teacher Organization, Ann Arbor, MI
Owings Mills Green Action Inc., Owings Mills, MD
Paul F. Buonodono Foundation, Okemos, MI
Penn State Club of Greater Baltimore Scholarship Fund, Miltersville, MD
P I E C C C S Inc., Towson, MD
Poplar Enterprise Development Corp., Philadelphia, PA
Port Huron Neighborhood Housing Corporation, Port Huron, MI
Positive Tree Inc., St. Thomas, VI
Prince Georges County CPR Awareness Foundation, Landover Hills, MD
PTO Indiana Congress Woodbrook, Carmel, IN
Puerto Rico Educational and Scientific Foundation Inc., Bayamon, PR
R & B Productions Indianapolis Afro-American Choral, Indianapolis, IN
Religious Outreach Network of Ohio, Rocky River, OH
Rescate Christian Home for Minors, Philadelphia, PA
Richard Community Theatre Inc., Richmond, MI
River Valley Child Development Services, Huntington, WV
Robert W. Depond Memorial Foundation, St. Louis, MO
Salt Lake Community Foundation Depository, Inc., The, Salt Lake City, UT
Sherman Family Trust, Deming, NM
South East Community Association, Grand Rapids, MI
Southern Kentucky Youth Basketball Leagues Inc., Bowling Green, KY
Sunshine Child Care Center Inc., Lafayette, IN
Tell City Junior High Band Booster Inc., Tell City, IN
Texans for Efficiency in Government, Inc., Houston TX

Trenton St. Patricks Day Parade Committee Inc., Trenton, NJ

Tri State Office of Traffic Safety Inc., Huntington, WV

Tuslow Parent-Teacher Organization of Massillon Ohio Tuslaw Local, North Lawrence, OH

United Social Action, Inc., Lawton, OK

West Virginia Federation of Parents for Drug Free Youth Inc., Keyser, WV

Westway Gardens Housing Corp., Lorain, OH

What If Inc., Cincinnati, OH

Windwalker Wildlife Sanctuary, Stockbridge, MI

Womens Learning Resource, The, Albuquerque, NM

World War II National Commemorative Assoc. Inc., Indianapolis, IN

If an organization listed above submits information that warrants the renewal of its classification as a public charity or as a private operating foundation, the Internal Revenue Service will issue a ruling or determination letter with the revised classification as to foundation status. Grantors and contributors may thereafter rely upon such ruling or determination letter as provided in section 1.509(a)–7 of the Income Tax Regulations. It is not the practice of the Service to announce such revised classification of foundation status in the Internal Revenue Bulletin.

Definition of Terms

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

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

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

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

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

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

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

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

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

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

Abbreviations

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

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

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Superseded by
96–6, 1996–1 I.R.B. *151*

95–7
Superseded by
96–7, 1996–1 I.R.B. *185*

95–8
Superseded by
96–8, 1996–1 I.R.B. *187*

95–13
Superseded by
96–20, 1996–4 I.R.B. *88*

Revenue Procedures—Continued

95–20
Superseded by
96–24, 1996–5 I.R.B. *28*

95–50
Superseded by
96–3, 1996–1 I.R.B. *82*

96–3
Amplified by
96–12, 1996–3 I.R.B. *30*

Revenue Rulings:

66–307
Obsoleted by
96–3, 1996–2 I.R.B. *14*

72–437
Modified by
96–13, 1996–3 I.R.B. *31*

80–80
Obsoleted by
96–3, 1996–2 I.R.B. *14*

82–80
Modified by
96–14, 1996–3 I.R.B. *41*

92–19
Supplemented in part
96–2, 1996–2 I.R.B. *5*

92–75
Clarified by
96–13, 1996–3 I.R.B. *31*

95–10
Supplemented and superseded by
96–4, 1996–3 I.R.B. *16*

95–11
Supplemented and superseded by
96–5, 1996–3 I.R.B. *29*

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