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§1.409A-1 Definitions and covered plans.

(a) (1) Nonqualified deferred compensation plan. (1) In general. Except as otherwise provided in this paragraph (a), the term nonqualified deferred compensation plan means any plan (within the meaning of paragraph (c) of this section) that provides for the deferral of compensation (within the meaning of paragraph (b) of this section). Whether a plan provides for the deferral of compensation generally is determined at the time the service provider obtains a legally binding right to the compensation under the plan, and is not affected by any retroactive change to the plan to characterize the right as one that does not provide for the deferral of compensation. For example, amounts deferred under a nonqualified deferred compensation plan do not become an excluded death benefit if the plan is amended so that the amounts are payable only upon the death of the service provider. If a principal purpose of a plan is to achieve a result with respect to a deferral of compensation that is inconsistent with the purposes of section 409A, the
Commissioner may treat the plan as a nonqualified deferred compensation plan for purposes of section 409A and the regulations thereunder.

(2) **Qualified employer plans.** The term nonqualified deferred compensation plan does not include— a qualified employer plan. The term qualified employer plan means any of the following plans:

(i) Any plan described in section 401(a) that includes and a trust exempt from tax under section 501(a), or that is described in section 402(d).

(ii) Any annuity plan described in section 403(a).

(iii) Any annuity contract described in section 403(b).

(iv) Any simplified employee pension (within the meaning of section 408(k)).

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(3) **Certain foreign plans—**

(i) Participation addressed by treaty. With respect to an individual for a taxable year, the term nonqualified deferred compensation plan does not include any scheme, trust, arrangement, or plan maintained with respect to such individual, where to the extent contributions made by or on behalf of such individual to such scheme, trust, arrangement, or plan, or credited allocations, accrued benefits, earnings, or other amounts constituting income, of such individual under such scheme, trust, arrangement, or plan, are includible by such individual for Federal income tax purposes pursuant
to any bilateral income tax convention to which the United States is a party.

(ii) Participation by nonresident aliens and certain resident aliens, and bona fide residents of possessions. With respect to an alien individual for a taxable year during which such individual is a nonresident alien or a resident alien classified as a resident alien solely under section 7701(b)(1)(A)(ii) (and not section 7701(b)(1)(A)(i)), or a bona fide resident of a possession (within the meaning of section 937(a)), the term nonqualified deferred compensation plan does not include any broad-based foreign retirement plan (within the meaning of paragraph (a)(3)(v) of this section) maintained by a person that is not a United States person.

(iii) Participation by U.S. citizens and lawful permanent residents. With respect to an individual for a given taxable year during which such individual is a U.S. citizen or a resident alien classified as a resident alien under section 7701(b)(1)(A)(i), and is not eligible to participate in a qualified employer plan described in paragraph (a)(2) of this section or a plan of the service recipient that is not a United States person, but only with respect to a plan, or a portion of a plan where such portion may be distinguished, providing for nonelective deferrals of modified foreign earned income (as defined in section 911(b)(1)), and earnings with respect to such nonelective deferrals, and only to the extent that the amounts deferred under such plan all such plans of the service recipient, or all portions of such plans, in which the service provider participates in such taxable year, do not exceed the applicable limits under section 415(b) and (c) (applied to nonaccount balance plans as defined in paragraph (c)(2)(i)(C) of this section) and section 415(c) (applied to account balance plans as defined in paragraph (c)(2)(i)(A) of this section) that would be applicable if such plan plans were subject to section 415 and the modified foreign earned income of such individual were treated as compensation for purposes of applying section 415(b) and (c). For purposes of this paragraph (a)(3)(iii), the term modified foreign earned income means foreign earned
income as defined in section 911(b)(1) without regard to section 911(b)(1)(B)(iv) and without regard to the requirement that the income be attributable to services performed during the period described in section 911(d)(1)(A) or (B). The provisions of this paragraph (a)(3)(iii) do not apply to any individual with respect to any taxable year in which the individual is simultaneously eligible to participate in a broad-based foreign retirement plan and a qualified employer plan described in paragraph (a)(2) of this section. For purposes of this paragraph (a)(3)(iii), an individual is eligible to participate in a qualified employer plan if under the terms of the plan and without further amendment or action by the plan sponsor, the individual is eligible to make or receive contributions or accrue benefits under the plan (regardless of whether the individual has elected to participate in the plan).

(iv) Plans subject to a totalization agreement and similar plans. The term nonqualified deferred compensation plan does not include any social security system of a jurisdiction to the extent that benefits provided under or contributions made to the system are subject to an agreement entered into pursuant to section 233 of the Social Security Act (42 U.S.C. 433) with any foreign jurisdiction. In addition, the term nonqualified deferred compensation plan does not include a social security system of a foreign jurisdiction to the extent that benefits are provided under or contributions are made to a government-mandated plan as part of that foreign jurisdiction’s social security system.

(v) Broad-based foreign retirement plan. For purposes of this paragraph (a)(3), the term broad-based foreign retirement plan means a scheme, trust or arrangement that—arrangement, or plan (regardless of whether sponsored by a U.S. person) that is written and that, in the case of an employer-maintained plan, satisfies the following conditions:

(A)---Is written:

(B) In the case of an employer-maintained plan, the plan is nondiscriminatory insofar as the employees who, under the terms of the plan (alone or in combination with other comparable plans) cover, and without further amendment or action by the employer, are eligible to make or receive
contributions or accrue benefits under the plan other than earnings (regardless of whether the employee has elected to participate in the plan), are a wide range of employees, substantially all of whom are nonresident aliens or resident aliens classified as resident aliens solely under section 7701(b)(1)(A)(ii) (and not section 7701(b)(1)(A)(i)), or bona fide residents of a possession (within the meaning of section 937(a)), including rank and file employees, and actually provides significant benefits for the range of covered employees:

(B) The plan (alone or in combination with other comparable plans) actually provides significant benefits for a substantial majority of such covered employees.

(C) The benefits actually provided under the plan to such covered employees are nondiscriminatory.

(D) In the case of an employer-maintained plan, contains provisions or is the subject of tax law provisions or other legal restrictions that generally limit the ability to use plan benefits for purposes other than retirement or restrict access to plan benefits prior to separation from service, such as including (but not limited to), restricting in-service distributions except in events similar to an unforeseeable emergency (as defined in § 1.409A-3(g)(3)(i)) or hardship (as defined for purposes of section 401(k)(2)(B)(i)(IV)), and in all cases is subject to tax or plan provisions that discourage participants from using the assets for educational purposes other than retirement; and

(D) Provides for payment of a reasonable level of benefits at death, a stated age, or an event related to work status, and otherwise requires minimum distributions under rules designed to ensure that any death benefits provided to the participant’s survivors are merely incidental to the retirement benefits provided to the participant.

(vi) Participation by a nonresident alien — de minimis amounts. With respect to a nonresident alien, the term
nonqualified deferred compensation plan does not include any foreign plan maintained by a service recipient that is not a United States person for a taxable year, to the extent that the amounts deferred under the foreign plan based upon the nonresident alien’s services performed in the United States (including compensation received due to services performed in the United States) do not exceed $10,000 in the taxable year or the purchase of a primary residence.

(4) **Section 457 plans.** A nonqualified deferred compensation plan under section 457(f) may constitute a nonqualified deferred compensation plan for purposes of this paragraph (a). The rules of section 409A apply to nonqualified deferred compensation plans separately and in addition to any requirements applicable to such plans under section 457(f). In addition, nonelective deferred compensation of nonemployees described in section 457(e)(12) and a grandfathered plan or arrangement described in § 1.457-2(k)(4) may constitute a nonqualified deferred compensation plan for purposes of this paragraph (a). The term nonqualified deferred compensation plan does not include a length of service award to a bona fide volunteer under section 457(e)(11)(A)(ii). For purposes of the application of section 409A to a plan to which section 457 applies, a payment under the plan generally means the provision of cash or property to the service provider, provided that for purposes of the application of the short-term deferral rule set forth in paragraph (b)(4) of this section, the inclusion in income of an amount under section 457(f) is treated as a payment of the amount.

(5) **Certain welfare benefits.** The term nonqualified deferred compensation plan does not include any bona fide vacation leave, sick leave, compensatory time, disability pay, or death benefit plan. For these purposes, the term “disability pay” has the same meaning as provided in § 31.3121(v)(2)-1(b)(4)(iv)(C) of this chapter, and the term death benefit plan refers to a plan providing death benefits as defined in § 31.3121(v)(2)-1(b)(4)(iv)(C) of this chapter, provided that for purposes of this paragraph, such disability pay and death benefits may be provided through insurance and the lifetime benefits payable under the plan are not treated as including the value of any taxable term life insurance coverage or taxable disability insurance coverage provided under the plan. The term nonqualified deferred compensation plan also does not include any Archer Medical Savings Account as described in section 220, any Health Savings Account as described in section 223, or any other medical reimbursement arrangement, including a health reimbursement arrangement, that satisfies the requirements of section 105 and section 106 such that the benefits or reimbursements provided under such arrangement are not includible in income.

**Deferral of compensation—**

**Deferral of compensation—(1) In general.** Except as otherwise provided in paragraphs (b)(3) through (b)(9) of this section, a plan provides for the deferral of compensation if, under the terms of the plan and the relevant facts and
circumstances, the service provider has a legally binding right during a taxable year to compensation that has not been actually or constructively received and included in gross income, and that, pursuant to the terms of the plan, is or may be payable to (or on behalf of) the service provider in a later taxable year. Such compensation is deferred compensation for purposes of section 409A, this section and §§1.409A-2 through 1.409A-6. A legally binding right to an amount that will be excluded from income when and if received does not constitute a deferral of compensation, unless the service provider has received the right in exchange for, or has the right to exchange the right for, an amount that will be includable in income (other than due to participation in a cafeteria plan described in section 125). A service provider does not have a legally binding right to compensation if to the extent that compensation may be reduced unilaterally or eliminated by the service recipient or other person after the services creating the right to the compensation have been performed. However, if the facts and circumstances indicate that the discretion to reduce or eliminate the compensation is available or exercisable only upon a condition, or the discretion to reduce or eliminate the compensation lacks substantive significance, a service provider will be considered to have a legally binding right to the compensation. Whether the negative discretion to reduce or eliminate the compensation lacks substantive significance depends on all the relevant facts and circumstances of the particular arrangement. However, where the service provider to whom the compensation may be paid has effective control of the person retaining the discretion to reduce or eliminate the compensation, or has effective control over any portion of the compensation of the person retaining the discretion to reduce or eliminate the compensation, or is a member of the family (as defined in section 267(c)(4) applied as if the family of an individual includes the spouse of any member of the family) of the person retaining the discretion to reduce or eliminate the compensation, the discretion to reduce or eliminate the compensation will not be treated as having substantive significance. 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 nondiscretionary, objective provision creating a substantial risk of forfeiture. Similarly, a service provider 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 another plan (including a plan that is qualified under section 401(a)), or because benefits are reduced due to actual or notional investment losses, or in a final average pay plan, subsequent decreases in compensation.

(2) Earnings. References to the deferral of compensation or deferred compensation include references to earnings. When the right to earnings is specified under the terms of the arrangement plan, the legally binding right to earnings arises at the time of the deferral of the compensation to which the earnings relate. However, a plan may provide that the right to the time and form of payment of earnings is treated separately from the right to the time and form of payment of the underlying compensation. For example, so that, provided that the rules of section 409A are otherwise met, a plan may provide that earnings will be paid at a separate time or in a separate form from the payment of the underlying compensation. For the application of the deferral election rules to current payments of earnings and dividend equivalents, see § 1.409A-23(a)(13c).
(3) **Compensation payable pursuant to the service recipient’s customary payment timing arrangement.** A deferral of compensation does not occur solely because compensation is paid after the last day of the service provider’s taxable year pursuant to the timing arrangement under which the service recipient normally compensates service providers for services performed during a payroll period described in section 3401(b), or with respect to a non-employee service provider, a period not longer than the payroll period described in section 3401(b) or if no such payroll period exists, a period not longer than the earlier of the normal timing arrangement under which the service provider normally compensates non-employee service providers or 30 days after the end of the service provider’s taxable year.

(4) **Short-term deferrals—**

(i) **In general.** A deferral of compensation does not occur if the plan under which a payment (as defined in §1.409A-2(b)(2)) is made does not provide for a deferred payment and the service provider actually or constructively receives such payment on or before the last day of the applicable 2 ½ month period. The following rules apply for purposes of this paragraph (b)(4)(i):

(ii) **In general.** A deferral of compensation does not occur if, absent an election by the service provider (including an election under §1.409A-2(a)(4)) to otherwise defer the payment of the compensation to a later period, an amount of compensation is actually or constructively received by the service provider by

(A) **The applicable 2 ½ month period is the period ending on the later of the 15th day of the third month following the end of the service provider’s first taxable year in which the amount right to the payment is no longer subject to a substantial risk of forfeiture or the 15th day of the third month following the end of the service recipient’s first taxable year in which the amount right to the payment is no longer subject to a substantial risk of forfeiture.** In addition, the arrangement must not otherwise defer the payment to a later period. For example, an arrangement that deferred a payment until 5 years after the lapsing of a condition that constituted a substantial risk of forfeiture would constitute a deferral of compensation even if the amount were actually paid on the date the substantial risk of forfeiture lapsed. For these purposes, an amount

(B) **A payment is treated as actually or constructively received** if the payment is includible in income, including if the payment is includible in income
under section 83, the economic benefit doctrine, section 402(b), or section 457(f).

(C) A right to a payment that is never subject to a substantial risk of forfeiture is considered to be no longer subject to a substantial risk of forfeiture on the first date the service provider has a legally binding right to the amount. For example, an employer with a calendar year taxable year who on November 1, 2008, awards a bonus so that the employee is considered to have a legally binding right to the payment as of November 1, 2008, will not be considered to have provided for a deferral of compensation if, absent an election to otherwise defer the payment, the amount is paid or made available to the employee on or before March 15, 2009. An employer with a taxable year ending August 31 who on November 1, 2008, awards a bonus so that the employee is considered to have a legally binding right to the payment as of November 1, 2008, will not be considered to have provided for a deferral of compensation if, absent an election to otherwise defer the payment, the amount is paid or made available to the employee on or before November 15, 2009.

(D) A plan provides for a deferred payment if the plan provides that any payment will be made or completed on or after any date, or upon or after the occurrence of any event, that will or may occur later than the end of the applicable 2 ½ month period, such as a separation from service, death, disability, change in control event, specified time or schedule of payment, or unforeseeable emergency, regardless of whether an amount is actually paid as a result of the occurrence of such a payment date or event during the applicable 2 ½ month period. If a plan provides that the service provider or service recipient may make an election under the plan (including an election under §1.409A-2(a)(4)) of a different payment date, schedule, or event, such right is disregarded for this purpose. In such cases, whether a plan provides for a deferred payment is determined based on the payment date, schedule, or event that would apply if no such election were made, except that if the plan would not provide for a deferred payment absent such an election, and the
service provider or service recipient makes such an election, whether the plan provides for a deferred payment is determined based upon the payment date, schedule, or event that the service provider or service recipient in fact elected.

(E) A stock right provides for a deferred payment if such right includes any provision pursuant to which the holder of the stock right will or may have the right to exercise the stock right after the applicable 2 ½ month period.

(F) This paragraph (b)(4)(i) is applied separately to each payment (as defined in §1.409A-2(b)(2)) required to be made under a plan.

(G) If a plan provides for a deferred payment with respect to part of a payment (for example a life annuity or a series of installment amounts treated as a single payment), the plan provides for a deferred payment with respect to the entire payment.

(ii) Delayed Certain delayed payments due to unforeseeable events. A payment that otherwise qualifies as a short-term deferral under paragraph (b)(4)(i) of this section but is made after the 15th day of the third month following the end of the relevant taxable year (the applicable 2 ½ month period) may continue to qualify as a short-term deferral if the taxpayer establishes that it was administratively impracticable to make the payment by the end of the applicable 2 ½ month period or that making the payment by the end of the applicable 2 ½ month period would have jeopardized the solvency of the service recipient, and, as of the date upon which the legally binding right to the compensation arose, such impracticability or insolvency was unforeseeable, and also the payment is made as soon as reasonably practicable. For example, an amount that would otherwise qualify as a short-term deferral except that the payment is made after the applicable 2 ½ month period may continue to qualify as a short-term deferral under this paragraph (b)(4) to the extent that the delay is caused either because the funds of the service recipient were not sufficient to make the payment before the end of the applicable 2 ½ month period without jeopardizing the solvency of the service recipient, or because it was not reasonably possible to determine was unforeseeable, or the
taxpayer establishes that making the payment by the end of the applicable 2 ½ month period whether payment of such amount was to be made, and the circumstance causing the delay was unforeseeable as of the date upon which the legally binding right to the compensation arose. Thus, the amount will not continue to qualify as a short-term deferral to the extent it was foreseeable, as of date upon which the legally binding right to the compensation arose, that the amount would not be paid within the applicable 2 ½ month period would have jeopardized the ability of the service recipient to continue as a going concern, and provided further that the payment is made as soon as administratively practicable or as soon as the payment would no longer have such effect. For purposes of this paragraph (b)(4)(ii), an action or failure to act of the service provider or a person under the service provider’s control, such as a failure to provide necessary information or documentation, is not an unforeseeable event. In addition, a payment that otherwise qualifies as a short-term deferral under paragraph (b)(4)(i) of this section but is made after the applicable 2 ½ month period may continue to qualify as a short-term deferral if the taxpayer establishes that the service recipient reasonably anticipated that the service recipient’s deduction with respect to such payment otherwise would not be permitted by application of section 162(m), and, as of the date the legally binding right to the payment arose, a reasonable person would not have anticipated the application of section 162(m) at the time of the payment, and provided further that the payment is made as soon as reasonably practicable following the first date on which the service recipient anticipates or reasonably should anticipate that, if the payment were made on such date, the service recipient’s deduction with respect to such payment would no longer be restricted due to the application of section 162(m). For additional rules applicable to certain transaction-based compensation, see §1.409A-3(i)(5)(iv)(A). Examples. The following examples illustrate the provisions of this paragraph (b)(4). In these examples, except as otherwise noted, each employee and each employer has a calendar year taxable year and each employee is an individual who is employed by the specified employer.

(5) Stock options, stock appreciation rights and other equity-based compensation
Example 1. On November 1, 2008, Employer Z awards a bonus to Employee A such that Employee A has a legally binding right to the payment as of November 1, 2008, that is not subject to a substantial risk of forfeiture. The bonus plan does not provide for a payment date or a deferred payment. The bonus plan will not be considered to have provided for a deferral of compensation if the bonus is paid or made available to Employee A on or before March 15, 2009.

Example 2. Employer Y has a taxable year ending August 31. On November 1, 2008, Employer Y awards a bonus to Employee B so that Employee B has a legally binding right to the payment as of November 1, 2008, that is not subject to a substantial risk of forfeiture. The bonus plan does not provide for a payment date or a deferred payment. The bonus plan will not be considered to have provided for a deferral of compensation if the bonus is paid or made available to Employee B on or before November 15, 2009.

Example 3. On November 1, 2008, Employer X awards a bonus to Employee C such that Employee C has a legally binding right to the payment as of November 1, 2008. Under the bonus plan, Employee C will forfeit the bonus unless Employee C continues performing services through December 31, 2010. The right to the payment is subject to a substantial risk of forfeiture through December 31, 2010. Employee C has the right to make a written election not later than December 31, 2009, to receive the bonus on or after December 31, 2015, but Employee C does not make such election. The bonus plan does not provide for a default payment date or a deferred payment in the absence of an election by Employee C. The bonus plan will not be considered to have provided for a deferral of compensation if the bonus is paid or made available to Employee C on or before March 15, 2011 (and generally any payment before June 1, 2011 would constitute an impermissible acceleration of a payment).

Example 4. On November 1, 2008, Employer W awards a bonus to Employee D such that Employee D has a legally binding right to the payment as of November 1, 2008. Under the bonus plan, the bonus will be determined based on services performed during the period from January 1, 2009 through December 31, 2010. The bonus is scheduled to be paid as a lump sum payment on February 15, 2011. Under the bonus plan, Employee D will forfeit the bonus unless Employee D continues performing services through the scheduled payment date (February 15, 2011). Provided that at all times before the scheduled payment date Employee D is required to continue to perform services to retain the right to the bonus, and the bonus is paid on or before March 15, 2012, the bonus plan will not be considered to have provided for a deferral of compensation.

Example 5. On November 1, 2008, Employer V awards a bonus to Employee E such that Employee E has a legally binding right to the payment as of November 1, 2008. Under the bonus plan, Employee E will forfeit the bonus unless Employee E continues performing services through December 31, 2010. Under the bonus plan, the bonus is scheduled to be paid as a lump sum payment on July 1, 2011.
By specifying a payment date after the applicable 2 ½ month period, the bonus plan provides for a deferred payment. The bonus plan provides for a deferral of compensation, and will not qualify as a short-term deferral regardless of whether the bonus is paid or made available on or before March 15, 2011.

Example 6. On November 1, 2008, Employer U awards a bonus to Employee F such that Employee F has a legally binding right to the payment as of November 1, 2008, that is not subject to a substantial risk of forfeiture. The bonus plan provides for a lump sum payment upon Employee F’s separation from service. Because the separation from service is an event that may occur after the applicable 2 ½ month period, the bonus plan provides for a deferred payment and therefore provides for a deferral of compensation. Accordingly, the bonus plan will not qualify as a short-term deferral regardless of whether Employee F separates from service and the bonus is paid or made available on or before March 15, 2009.

Example 7. On November 1, 2008, Employer T grants Employee G a legally binding right to the payment of a life annuity with the first annuity payment on November 1, 2013, provided that Employee G continues performing services for Employer T continuously through November 1, 2013. Because the life annuity is treated as a single payment, and because all payments of the life annuity may not occur during the applicable 2 ½ month period, the plan provides for a deferred payment and none of the amounts payable under the annuity will qualify as a short-term deferral, so that section 409A applies to all amounts that are payable under the plan.

Example 8. On November 1, 2008, Employer S grants Employee H a stock right providing for an exercise price less than the fair market value of the underlying stock on November 1, 2008. The stock right is subject to a substantial risk of forfeiture requiring services through November 1, 2010. The stock right becomes exercisable when the substantial risk of forfeiture lapses and expires on November 1, 2013. Employee H continues providing services through November 1, 2010, at which time the substantial risk of forfeiture lapses. The stock right provides for a deferred payment and will not qualify as a short-term deferral regardless of whether Employee H exercises the stock right on or before March 15, 2011.

(5) (A) Stock options, stock appreciation rights, and other equity-based compensation—(i) Stock rights—(A) Nonstatutory stock options not providing for the deferral of compensation. An option to purchase service recipient stock does not provide for a deferral of compensation if—

(1) The amount required to purchase stock under the option (the exercise price) may never be less than the fair market value of the underlying stock (disregarding lapse restrictions as defined in § 1.83-3(i)) on the date the option is granted and the number of shares subject to the option is fixed on the original date of grant of the option;
(2) The transfer or exercise of the option is subject to taxation under section 83 and § 1.83-7; and

(3) The option does not include any feature for the deferral of compensation other than the deferral of recognition of income until the later of the following:

(i) The exercise or disposition of the option under § 1.83-7, or the 1.83-7.

(ii) The time the stock acquired pursuant to the exercise of the option first becomes substantially vested (as defined in § 1.83-3(b)).

(B) Stock appreciation rights not providing for the deferral of compensation. A right to compensation equal to based on the appreciation in value of a specified number of shares of stock of the service recipient stock occurring between the date of grant and the date of exercise of such right (a stock appreciation right) does not provide for a deferral of compensation if—

(1) Compensation payable under the stock appreciation right cannot be greater than the difference between excess of the fair market value of the stock (disregarding lapse restrictions as defined in § 1.83-3(i)) on the date the stock appreciation right is exercised over an amount specified on the date of grant of the stock appreciation right and the fair market value of the stock (disregarding lapse restrictions as defined in § 1.83-3(i)) on the date the stock appreciation right is exercised (the stock appreciation right exercise price), with respect to a number of shares fixed on or before the date of grant of the right;

(2) The stock appreciation right exercise price may never be less than the fair market value of the underlying stock (disregarding lapse restrictions as defined in § 1.83-3(i)) on the date the right is granted; and
The stock appreciation right does not include any feature for the deferral of compensation other than the deferral of recognition of income until the exercise of the stock appreciation right.

Stock rights that may provide for the deferral of compensation. An option to purchase stock other than service recipient stock, or a stock appreciation right with respect to stock other than service recipient stock, generally will provide for the deferral of compensation within the meaning of this paragraph (b). If under the terms of an option to purchase service recipient stock (other than an incentive stock option described in section 422 or a stock option granted under an employee stock purchase plan described in section 423), the amount required to purchase the stock exercise price is or could become less than the fair market value of the stock (disregarding lapse restrictions as defined in §1.83-3(i)) on the date of grant, the grant of the option may generally will provide for the deferral of compensation within the meaning of this paragraph (b). If under the terms of a stock appreciation right with respect to service recipient stock, the compensation payable under the stock appreciation right is or could be any amount greater than, with respect to a predetermined number of shares, the difference between excess of the fair market value of the stock value (disregarding lapse restrictions as defined in §1.83-3(i)) on the date of grant of the stock appreciation right and the stock value (disregarding lapse restrictions as defined in §1.83-3(i)) on the date the stock appreciation right is exercised over the fair market value of the stock (disregarding lapse restrictions as defined in §1.83-3(i)) on the date of grant of the stock appreciation right, the grant of the stock appreciation right may generally will provide for a deferral of compensation within the meaning of this paragraph (b).

Feature for the deferral of compensation. To the extent a stock right grants the recipient provides a right other than the right to receive cash or stock on the date of exercise and such additional right would otherwise allow for the deferral of
compensation to be deferred beyond the date of exercise, the entire arrangement (including the underlying stock right) provides for the deferral of compensation. For purposes of this paragraph (b)(5)(i), neither the right to receive substantially nonvested stock (as defined in § 1.83-3(b)) upon the exercise of a stock right, nor the right to pay the exercise price with previously acquired shares, constitutes a feature for the deferral of compensation.

(E) Rights to dividends declared. For purposes of this paragraph (b)(5)(i), the right to receive, directly or indirectly contingent upon the exercise of a stock right, to receive an amount equal to all or part of the dividends or other distributions (other than stock dividends described in paragraph (b)(5)(v)(H) of this section) declared and paid on the number of shares underlying the stock right between the date of grant and the date of exercise of the stock right constitutes an offset to the exercise price of the stock option or an increase in the amount payable under the stock appreciation right (generally causing such stock right to be subject to section 409A), unless the A plan providing a right to the dividends or other distributions declared and paid on the number of shares underlying the stock right is explicitly set forth as a separate arrangement. If set forth as a separate arrangement, the arrangement may provide for deferred compensation for purposes of section 409A. However, a stock right, the payment of which is not contingent upon, or otherwise payable on, the exercise of the stock right, may provide for a deferral of compensation, but the existence of a separate arrangement to receive such an amount that complies with the requirements of section 409A would not cause a will not be treated as a reduction to the exercise price of (or an increase to the compensation payable under) the stock right. Thus, a right to such dividends or distributions that is not contingent, directly or indirectly, upon the exercise of a stock right will not cause the related stock right to fail to satisfy the requirements of the exclusion from the definition of deferred compensation provided in paragraphs (b)(5)(i)(A) and (B) of this section.
(ii) Statutory stock options. The grant of an incentive stock option as described in section 422, or the grant of an option under an employee stock purchase plan described in section 423 (including the grant of an option with an exercise price discounted in accordance with section 423(b)(6) and the accompanying regulations), does not constitute a deferral of compensation. However, the exclusion for statutory stock options under this paragraph (b)(5)(ii) does not apply to a modification, extension, or renewal of a statutory option that is treated as the grant of a new option that is not a statutory option. See §1.424-1.4241(e). In such event, the option is treated for purposes of this paragraph (b) as if it were had been a nonstatutory stock option at from the date of the original grant. Accordingly, so that the modification, extension or renewal of the stock option that caused the stock option to be treated as the grant of a new option under §1.424-1(e) is treated as causing the option to be treated as the grant of a new option for purposes of this paragraph (b)(5) only if such modification, extension, or renewal of the stock option would have been treated as resulting in the grant of a new option or as causing the option to have had a deferral feature from the date of grant under paragraph (b)(5)(v) of this section, the modification, extension, or renewal of the stock option is treated as the grant of a new option or as causing the option to have had a deferral feature from the date of grant for purposes of this paragraph (b)(5).

(iii) Stock of the service recipient—

(iii) (A) Service recipient stock—(A) In general. Except as otherwise provided in paragraphs (b)(5)(iii)(B), (C), and (D) of this section, for purposes of this section, stock of the term service recipient stock means a class of stock that, as of the date of grant, is common stock for purposes of section 305 and the regulations thereunder of a corporation that is a service recipient (including any member of a group of corporations or other entities treated as a single service recipient) that is readily tradable on an established securities market, or if none, that class of common stock of such corporation having the greatest aggregate value of common stock issued and outstanding of such corporation, or common stock with substantially similar rights to stock of such class (disregarding any difference in voting rights). However, under no circumstances does stock of the service recipient
include stock that is preferred as to liquidation or dividend rights or that includes an eligible issuer of service recipient stock (as defined in paragraph (b)(5)(iii)(E) of this section). Notwithstanding the foregoing, the term service recipient stock does not include a class of stock that has any preference as to distributions other than distributions of service recipient stock and distributions in liquidation of the issuer. The term service recipient stock also does not include any stock that is subject to a mandatory repurchase obligation (other than a right of first refusal), or a put or call right that is not a lapse restriction as defined in § 1.83-3(i) and, if the stock price under such right or obligation is based on a measure other than the fair market value (disregarding lapse restrictions as defined in § 1.83-3(i)) of the equity interest in the corporation represented by the stock.

(B) American depositary receipts. For purposes of this section, an American depositary receipt or American depositary share may constitute service recipient stock, to the extent that the stock traded on a foreign securities market to which the American depositary receipt or American depositary share relates qualifies as service recipient stock.

(C) Mutual company units. For purposes of this section, mutual company units may constitute service recipient stock. For this purpose, the term mutual company unit means a fixed percentage of the overall value of a non-stock mutual company or association. For purposes of determining the value of the mutual company unit, the unit may be valued in accordance with the rules set forth in paragraph (b)(5)(iv)(B) of this section governing valuation of service recipient stock the shares of which are not traded on an established securities market, applied as if the mutual company were a stock corporation with one class of common stock and the number of shares of such stock determined according to the fixed percentage. For example, an appreciation right based on the appreciation of 10 mutual company units, where each unit is defined as one percent of the overall value of the mutual company, would be valued as if the appreciation right were based upon 10 shares of a corporation with 100 shares of common stock.
(and no other class of stock), whose shares of which are not readily tradable on an established securities market.

(D) **Definition of service recipient—Other entities.** An interest in an entity other than a corporation or nonstock mutual company or association may constitute service recipient stock to the extent designated by the Commissioner in revenue procedures, notices, or other guidance published in the Internal Revenue Bulletin (see §601.601(d)(2) of this chapter).

(E) (1) **In general.** For purposes of this paragraph (b)(5)(iii), the term service recipient generally includes the following:

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(E) (1) **Eligible issuer of service recipient stock—In general.** The term eligible issuer of service recipient stock means only the corporation for which the service provider provides direct services on the date of grant of the stock right (if the entity receiving such services is a corporation), and any corporation in a chain of corporations or other entities in which each corporation or other entity has a controlling interest in another corporation or other entity in the chain, ending with the corporation or other entity that has a controlling interest in the corporation or other entity for which the service provider provides direct services on the date of grant of the stock right. For this purpose, the term controlling interest has the same meaning as provided in paragraph (g) of this section, provided that in applying section 1563(a)(1), (2) and (3) for purposes of determining a controlled group of corporations under section 414(b), the language “at least 50 percent” is used instead of “at least 80 percent” each place it appears in section 1563(a)(1), (2) and (3), and in applying §1.414(c)-2 for purposes of determining trades or businesses (whether or not incorporated) that are under common control for purposes of section 414(e), §1.414(c)-2(b)(2)(i), provided that the language “at least 50 percent” is used instead of “at least 80 percent” each place it appears in §1.414(c)-2(b)(2)(i). In addition, where the use of such stock with respect to the grant of a stock right to
such service provider is based upon legitimate business criteria, the term service recipient controlling interest has the same meaning as provided in paragraph (g) of this section, provided that the stock right, or the plan or arrangement under which the stock right is granted, may specify that in applying sections 1563(a)(1), (2) and (3) for purposes of determining a controlled group of corporations under section 414(b), §1.414(c)-2(b)(2)(i), provided that the language “at least 20 percent” is used instead of “at least 80 percent” at each place it appears in sections 1563(a)(1), (2) and (3), and in applying §1.414(c)-2 for§1.414(c)-2(b)(2)(i). For purposes of determining trades or businesses (whether or not incorporated) that are under common control for purposes of section 414(c), the language “at least 20 percent” is used instead of “at least 80 percent” at each place it appears in §1.414(c)-2. Ownership of an interest in an organization, the rules of §§1.414(c)-3 and 1.414(c)-4 apply. The determination of whether a grant is based on legitimate business criteria is based on the facts and circumstances, focusing primarily on whether there is a sufficient nexus between the service provider and the issuer of the stock right so that the grant serves a legitimate non-tax business purpose other than simply providing compensation to the service provider that is excluded from the requirements of section 409A. For example, stock of a corporation participating that owns an interest in a joint venture involving an operating business, used with respect to stock rights granted to employees service providers of the joint venture who are former employees service providers of such corporation, generally will constitute use of such service recipient stock based upon legitimate business criteria, and therefore could constitute service provider recipient stock with respect to such employees service providers if the corporation owns at least 20 percent of the joint venture and the other requirements of this paragraph (b)(5)(iii) are met. A designation by a service recipient to use the 50 percent or 20 percent thresholds described in this paragraph (b)(5)(iii)(D) must be applied consistently as to all compensatory stock rights for purposes of this
paragraph (b)(5)(iii), and any designation of a different permissible ownership threshold percentage may not be made effective until 12 months after the adoption of such change. Similarly, the legitimate business criteria requirement generally would be met if the corporate venturer issued such a right to an employee of the joint venture who it reasonably expected would in the future become an employee of the corporate venturer. However, where a service provider has no real nexus with a corporate venturer, such as generally happens when the corporate venturer is a passive investor in the service recipient joint venture, a stock right issued to that employee on the investor corporation’s stock generally would not be based upon legitimate business criteria. Similarly, where a corporation holds only a minority interest in an entity that in turn holds a minority interest in the entity for which the service provider performs services, such that the corporation holds only an insubstantial indirect interest in the entity receiving the services, legitimate business criteria generally would not exist for issuing a stock right on the corporation’s stock to the service provider.

(2) **Investment vehicles.** Notwithstanding the provisions of paragraph (b)(5)(iii)(DE)(1) of this section, except as to a service provider providing services directly to such corporation, for purposes of this paragraph (b)(5)-the term, an eligible issuer of service recipient stock does not include any corporation whose primary purpose is to serve as an investment vehicle with respect to the corporation’s minority ownership interests in entities other than the service recipient.

(3) **Corporate structures established or transactions undertaken for purposes of avoiding coverage under section 409A.** Notwithstanding the provisions of paragraph (b)(5)(ii)(E)(1) of this section, an eligible issuer of service recipient stock does not include any corporation within a group of entities treated as a single service recipient if a purpose of the establishment of the
structure of the ownership, or a purpose of a significant transaction between or among two or more entities comprising a single service recipient, is to provide deferred compensation not subject to the application of section 409A. If an entity becomes a member of a group of corporations or other entities treated as a single service recipient, and the primary source of income or value of such entity arises from the provision of management services to other members of the service recipient group, it is presumed that such structure was established for purposes of avoiding the application of section 409A if any stock rights are issued with respect to such entity.

(4) Substitutions and assumptions by reason of a corporate transaction. If the requirements of paragraph (b)(5)(v)(D) of this section are met such that the substitution of a new stock right pursuant to a corporate transaction for an outstanding stock right, or the assumption of an outstanding stock right pursuant to a corporate transaction, would not be treated as the grant of a new stock right or a change in the form of payment for purposes of this section 409A and §§1.409A-2 through 1.409A-6, the stock underlying the stock right that replaced the stock right that is substituted or assumed will be treated as service recipient stock for purposes of applying this paragraph (b)(5) to the replacement stock rights if such underlying stock otherwise satisfies the requirements of paragraph (b)(5)(iii)(A) of this section. For example, where if by reason of a spinoff transaction (under which the stock of a subsidiary corporation is spun off from the stockholders of a distributing corporation), a distributing corporation employee’s stock option to purchase distributing corporation stock is replaced with a stock option to purchase distributing corporation stock and a stock option to purchase the spun off subsidiary corporation’s stock (each otherwise
satisfying the requirements of paragraph (b)(5)(ii)(A) of this section, and where such substitution is not treated as a modification of the original stock option pursuant to paragraph (b)(5)(v)(D) of this section, both the distributing corporation stock and the subsidiary corporation stock are treated as service recipient stock for purposes of applying this paragraph (b)(5) to the replacement stock options.

(E) Stock rights granted on or before December 31, 2004. Notwithstanding the requirements of paragraph (b)(5)(iii)(A) of this section, any class of common stock of the service recipient with respect to which stock rights were granted to service providers on or before December 31, 2004, is treated as service recipient stock for purposes of this paragraph (b)(5)(iii), but only with respect to stock rights granted on or before December 31, 2004.

(iv) Determination of the fair market value of service recipient stock—

(A) Stock readily tradable on an established securities market. For purposes of paragraph (b)(5)(i) of this section, in the case of service recipient stock that is readily tradable on an established securities market, the fair market value of the stock may be determined based upon the last sale before or the first sale after the grant, the closing price on the trading day before or the trading day of the grant, the arithmetic mean of the high and low prices on the trading day before or the trading day of the grant, or any other reasonable basis method using actual transactions in such stock as reported by such market and consistently applied. The determination of fair market value also may be based upon determined using an average selling price during a specified period that is within 30 days before or 30 days after the grant, provided that applicable valuation date, provided that the program under which the stock right is granted, including a program with a single participant, must irrevocably specify the commitment to grant the stock right based on such valuation method must be irrevocable with an exercise price set using such an average selling price before the beginning of the specified period.
period. and such valuation method must be used consistently for grants of stock rights under the same and substantially similar programs. For this purpose, the term average selling price refers to the arithmetic mean of such selling prices on all trading days during the specified period, or the average of such prices over the specified period weighted based on the volume of trading of such stock on each trading day during such specified period. To satisfy this requirement, the service recipient must designate the recipient of the stock right, the number and class of shares of stock that are subject to the stock right, and the method for determining the exercise price including the period over which the averaging will occur, before the beginning of the specified averaging period. Notwithstanding the forgoing provisions of this paragraph (b)(5)(iv)(A), where applicable foreign law requires that a compensatory stock right be priced based upon a specific price averaging method and period, a stock right granted in accordance with such applicable foreign law will be treated as meeting the requirements of this paragraph (b)(5)(iv)(A), provided that the averaging period does not exceed 30 days.

(B) Stock not readily tradable on an established securities market

(B) (1) In general. For purposes of paragraph (b)(5)(i) of this section, in the case of service recipient stock that is not readily tradable on an established securities market, the fair market value of the stock as of a valuation date means a value determined by the reasonable application of a reasonable valuation method. The determination of whether a valuation method is reasonable, or whether an application of a valuation method is reasonable, is made based on the facts and circumstances as of the valuation date. Factors to be considered under a reasonable valuation method include, as applicable, the value of tangible and intangible assets of the corporation, the present value of anticipated future cash flows of the corporation, the market value of stock or equity interests in similar corporations and other entities engaged in trades or businesses substantially similar to those engaged in by the corporation whose stock is to be valued, the value of which
can be readily determined through nondiscretionary, objective means (such as through trading prices on an established securities market or an amount paid in an arm’s length private transaction), recent arm’s length transactions involving the sale or transfer of such stock or equity interests, and other relevant factors such as control premiums or discounts for lack of marketability and whether the valuation method is used for other purposes that have a material economic effect on the service recipient, its stockholders, or its creditors. The use of a valuation method is not reasonable if such valuation method does not take into consideration in applying its methodology all available information material to the value of the corporation. Similarly, the use of a value previously calculated under a valuation method is not reasonable as of a later date if such calculation fails to reflect information available after the date of the calculation that may materially affect the value of the corporation (for example, the resolution of material litigation or the issuance of a patent) or the value was calculated with respect to a date that is more than 12 months earlier than the date for which the valuation is being used. The service recipient’s consistent use of a valuation method to determine the value of its stock or assets for other purposes, including for purposes unrelated to compensation of service providers, is also a factor supporting the reasonableness of such valuation method.

(2) Presumption of reasonableness. For purposes of this paragraph (b)(5)(iv)(B), the consistent use of any of the following methods of valuation is presumed to result in a reasonable valuation, provided that the Commissioner may rebut such a presumption upon a showing that either the valuation method or the application of such method was grossly unreasonable:

(i) A valuation of a class of stock determined by an independent appraisal that meets the requirements of section 401(a)(28)(C) and the regulations thereunder as of a date that is no more than 12 months
before the relevant transaction to which the valuation is applied (for example, the date of grant of a stock option).

(ii) A valuation based upon a formula that, if used as part of a nonlapse restriction (as defined in § 1.83-3(h)) with respect to the stock, would be considered to be the fair market value of the stock pursuant to § 1.83-5, provided that such stock is valued in the same manner for purposes of any nonlapse restriction applicable to the transfer of any shares of such class of stock (or any substantially similar class of stock), and all noncompensatory purposes requiring the valuation of such stock, including regulatory filings, loan covenants, issuances to and repurchases of stock from persons other than service providers, and other third-party arrangements to the issuer or any person that owns stock possessing more than 10 percent of the total combined voting power of all classes of stock of the issuer (applying the stock attribution rules of §1.424-1(d)), other than an arm’s length transaction involving the sale of all or substantially all of the outstanding stock of the issuer, and such valuation method is used consistently for all such purposes, and provided further that this paragraph (b)(5)(iv)(B)(2)(ii) does not apply with respect to stock subject to a stock right payable in stock, where the stock acquired pursuant to the exercise of the stock right is transferable other than through the operation of a nonlapse restriction.

(iii) A valuation, made reasonably and in good faith and evidenced by a
written report that takes into account the relevant factors described in paragraph (b)(5)(B)(iv)(B)(1) of this section, of an illiquid stock of a start-up corporation. For this purpose, an illiquid stock of a start-up corporation is means service recipient stock of a service recipient corporation that has no material trade or business that it or any predecessor to it has conducted for a period of 10 years or more and has no class of equity securities that are traded on an established securities market (as defined in paragraph (k) of this section), where such stock is not subject to any put or call, or other right or obligation of the service recipient or other person to purchase such stock (other than a right of first refusal upon an offer to purchase by a third party that is unrelated to the service recipient or service provider and other than a right or obligation that constitutes a lapse restriction as defined in § 1.83-3(i)), and provided that this paragraph (b)(5)(iv)(B)(2)(iii) does not apply to the valuation of any stock if the service recipient or service provider may reasonably anticipate, as of the time the valuation is applied, that the service recipient will undergo a change in control event as described in § 1.409A-3(g)(5)(iv) or § 1.409A-3(g)(5)(vii) within the 90 days following the action to which the valuation is applied, or make a public offering of securities within the 12 months following the event to which the valuation is applied (for example, the grant of a stock option or exercise of a stock appreciation right). For purposes of this paragraph (b)(5)(iv)(B)(2)(iii), a
valuation will not be treated as made reasonably and in good faith unless the valuation is performed by a person or persons with that the corporation reasonably determines is qualified to perform such a valuation based on the person’s or persons’ significant knowledge and experience or training in performing similar valuations, experience, education, or training. Generally, a person will be qualified to perform such a valuation if a reasonable individual, upon being apprised of such knowledge, experience, education, and training, would reasonably rely on the advice of such person with respect to valuation in deciding whether to accept an offer to purchase or sell the stock being valued. For this purpose, significant experience generally means at least five years of relevant experience in business valuation or appraisal, financial accounting, investment banking, private equity, secured lending, or other comparable experience in the line of business or industry in which the service recipient operates.

(3) Consistent use of a method. Use of alternative methods. For purposes of paragraph (b)(5)(iv)(B)(2) of this section, the consistent use of a valuation method means the consistent use of the method for all equity-based compensation arrangements, including with respect to stock rights, for purposes of determining the exercise price, and with respect to stock appreciation rights not paid in stock, for purposes of determining the payment at the date of exercise, and for stock appreciation rights or stock options paid in stock subject to a put or call right providing for the potential repurchase by the service recipient, or other obligation of the service recipient or other
person to purchase such stock, for purposes of determining the payment at the date of the purchase of such stock. Notwithstanding the foregoing, a service recipient may change the method prospectively for purposes of new grants of equity-based compensation, including stock rights. In addition, this paragraph (b)(5), a different valuation method may be used for each separate action for which a valuation is relevant, provided that a single valuation method is used for each separate action and, once used, may not retroactively be altered. For example, one valuation method may be used to establish the exercise price of a stock option, and a different valuation method may be used to determine the value at the date of the repurchase of stock pursuant to a put or call right. However, once an exercise price or amount to be paid has been established, the exercise price or amount to be paid may not be changed through the retroactive use of another valuation method. In addition, notwithstanding the foregoing, where after the date of grant, but before the date of exercise or transfer, of the stock right, the service provider stock to which the stock right relates becomes readily tradable on an established securities market, the service recipient must use the valuation method set forth in paragraph (b)(5)(iv)(A) of this section for purposes of determining the payment at the date of exercise or the purchase of the stock, as applicable.

(v) Modifications, extensions, renewals, substitutions and assumptions of stock rights—

(A) Modifications, extensions, substitutions, and assumptions of stock rights—(A) Treatment of modified and extended stock right as a new grant. Any modification of the terms of a stock right, other than an extension or renewal of the stock right, within the meaning of paragraph (b)(5)(v)(B) of this section is considered to be the granting of a new stock right. The new stock right may or may not constitute a deferral of compensation under paragraph (b)(5)(i) of this section,
determined at the date of grant of the new stock right. WhereIf there is an extension of a stock right is extended or renewed (within the meaning of paragraph (b)(5)(v)(C) of this section), the stock right is treated as having had an additional deferral feature from the date of grant original date of grant of the stock right, and therefore will be treated as a plan providing for the deferral of compensation from the original grant date for purposes of this paragraph (b).

(B) Modification in general. The Except as otherwise provided in paragraph (b)(5)(v) of this section, the term modification means any change in the terms of the stock right (or change in the terms of the arrangement plan pursuant to which the stock right was granted or in the terms of any other agreement governing the stock right) that may provide the holder of the stock right with a direct or indirect reduction in the exercise price of the stock right, or an additional deferral feature, or an extension or renewal of the stock right, regardless of whether the holder in fact benefits from the change in terms. In contrast, a change in the terms of the stock right shortening the period during which the stock right is exercisable is not a modification. It is not a modification to add a feature providing the ability to tender previously acquired stock for the stock purchasable under the stock right, or to withhold or have withheld shares of stock to facilitate the payment of the exercise price or the employment taxes or required withholding taxes resulting from the exercise of the stock right. In addition, it is not a modification for the grantor to exercise discretion specifically reserved under a stock right with respect to the transferability of the stock right.

(C) Extensions and renewals—(1) In general. An extension of a stock right refers to the granting provision to the holder of an additional period of time within which to exercise the stock right beyond the time originally prescribed; provided that it under the terms of the stock right, the conversion or exchange of a stock right for a legally binding right to compensation in a future taxable year, or the addition of any feature for the deferral of compensation not permitted in paragraph (b)(5)(i)(A)(3) of this section (in the case of a stock
option) or not permitted in paragraph (b)(5)(i)(B)(3) of this section (in the case of a stock appreciation right) to the terms of the stock right, other than at a time when the exercise price of the stock right equals or exceeds the fair market value of the service recipient stock that could be purchased (in the case of an option) or the fair market value of the service recipient stock used to determine the payment to the service provider (in the case of a stock appreciation right), and includes a renewal of such right that has such effect. It is not an extension if the exercise period of the stock right is extended to a date no later than the later of the 15th day of the third month following the date at which, or December 31 of the calendar year in which the stock right would otherwise have expired if the stock right had not been extended, based on the terms of the stock right at the original grant date. For example, an option granted January 1, 2011, that expires upon the earlier of January 1, 2021, or 30 days after separation from service will not be considered to be modified if, upon the holder’s separation from service on July 1, 2015, the term is extended to December 31, 2015. Notwithstanding the foregoing, earlier of the latest date upon which the stock right could have expired by its original terms under any circumstances or the 10th anniversary of the original date of grant of the stock right. If the exercise period of a stock right is extended at a time when the exercise price of the stock right equals or exceeds the fair market value of the service recipient stock that could be purchased (in the case of an option) or the fair market value of the service recipient stock used to determine the payment to the service provider (in the case of a stock appreciation right), it is not an extension of the original stock right. Instead, in such a case, the original stock right is treated as modified rather than extended and a new stock right is treated as having been granted for purposes of this section. In addition, it is not an extension of a stock right if the expiration of the stock right is tolled while the holder cannot exercise the stock right is unexercisable because such an exercise of the stock right would violate applicable securities laws would violate an applicable Federal, state,
local, or foreign law, or would jeopardize the ability of the service recipient to continue as a going concern, provided that the period during which the stock right may be exercised is not extended more than 30 days after the exercise of the stock right first would no longer violate an applicable securities laws. A renewal of a stock right is the granting by the corporation of the same rights or privileges contained in the original stock right on the same terms and conditions. Federal, state, local, and foreign laws or would first no longer jeopardize the ability of the service recipient to continue as a going concern. For this purpose, a provision of foreign law shall be considered applicable only to foreign earned income (as defined under section 911(b)(1) without regard to section 911(b)(1)(B)(iv) and without regard to the requirement that the income be attributable to services performed during the period described in section 911(d)(1)(A) or (B)) from sources within the foreign country that promulgated such law.

(2) Certain extensions before April 10, 2007. An extension of a stock right before April 10, 2007, solely in order to provide the holder of such stock right an additional period of time beyond the time originally prescribed under the terms of such stock right within which to exercise the stock right is disregarded for purposes of applying the rules contained in paragraph (b)(5)(v)(C)(1) of this section. For purposes of applying the rules contained in paragraph (b)(5)(v)(C)(1) of this section on and after April 10, 2007, such a stock right is treated as having specified at the date of grant the time within which to exercise such stock right that was prescribed under the terms of such stock right in effect on April 9, 2007. Nothing in this paragraph (b)(5)(v)(C)(2) affects any other action treated as the extension of a stock right, including the addition of a deferral feature.

(3) Examples. The following examples illustrate the provisions of this paragraph (b)(5)(v)(C). In the examples, each
employee is an individual employed by the specified employer, and each employee and each employer has a calendar year taxable year.

Example 1. On July 1, 2009, Employer Z grants Employee A a nonstatutory stock option that does not provide for the deferral of compensation in accordance with paragraph (b)(5)(i)(A) of this section. The terms of the nonstatutory stock option provide that the exercise period of the stock option expires on the earlier of July 1, 2019, or 3 months after Employee A’s separation from service. On July 1, 2011, Employee A separates from service. On the same day, Employee A and Employer Z change the exercise period of the option so that it expires on July 1, 2013. Because the exercise period of the stock right is not extended beyond July 1, 2019, the change is not an extension for purposes of this paragraph (b)(5)(v)(C).

Example 2. The facts are the same as in Example 1 except that Employee A separates from service on July 1, 2018, and on the same day, Employee A and Employer Z change the exercise period of the option so that it expires on July 1, 2020. As of July 1, 2018, the fair market value of the underlying stock exceeds the exercise price. Because the exercise period of the stock right is extended beyond July 1, 2019, the change is an extension for purposes of this paragraph (b)(5)(v)(C).

Example 3. The facts are the same as in Example 2 except that as of July 1, 2018, the fair market value of the underlying stock is less than the exercise price of the option. Because the exercise period of the stock right is extended at a time when the fair market value of the underlying stock is less than the exercise price, the change is not an extension for purposes of this paragraph (b)(5)(v)(C) and the change is treated as a modification of the option, resulting in the extension of the exercise period being treated as the grant of a new option on July 1, 2018.

Example 4. On July 1, 2009, Employer Y grants to Employee B a stock appreciation right with respect to 200 shares of Employer Y common stock that does not provide for the deferral of compensation in accordance with paragraph (b)(5)(i)(B) of this section. Upon exercise of the stock appreciation right, Employee B is entitled to receive the excess of the fair market value of a share of Employer Y common stock on the date of exercise over $100 (the fair market value of a share of Employer Y common stock on July 1, 2009), multiplied by the number of shares with respect to which Employee B is exercising the right. The exercise period of the right expires on the earlier of July 1, 2019, or 3 months after Employee B separates from service. Employee B cannot exercise the stock appreciation right with respect to more than 100 shares unless Employee B continues to be employed by Employer Y through June 30, 2014. On July 1, 2011, when the fair market value of a share of Employer Y common stock is $200, Employee B and Employer Y amend the stock appreciation right to provide that the right will be exercisable only during calendar year 2018, except that before January 1, 2017, Employee B may elect to designate calendar year 2023 or any subsequent calendar year before 2033 as the year in which the right will be exercisable. The amendment constitutes an extension of the stock appreciation right under paragraph (b)(5)(v)(C)(1) of
this section. Under paragraph (b)(5)(v)(A) of this section, the stock appreciation right is treated as having had an additional deferral feature from the original date of grant (July 1, 2009) of the right, and therefore is treated as a plan providing for the deferral of compensation from that date. During the period from July 1, 2009, through June 30, 2011, the provisions of the stock appreciation right relating to the time and form of payment did not satisfy the requirements of §1.409A-3(a). Therefore, the stock appreciation right provides for a deferral of compensation that does not comply with section 409A.

(D) Substitutions and assumptions of stock rights by reason of a corporate transaction. If the requirements of § 1.424-1 (without regard to the requirement described in §1.424-1(a)(2) that an eligible corporation be the employer of the optionee) would be met if the stock right were a statutory option, the substitution of a new stock right pursuant to a corporate transaction (as defined in §1.4241(a)(3)) for an outstanding stock right or the assumption of an outstanding stock right pursuant to a corporate transaction will not be treated as the grant of a new stock right or a change in the form of payment for purposes of this section 409A and §§1.409A-2 through 1.409A-6. For purposes of the preceding sentence, the requirement of § 1.424-1(a)(5)(iii) will be deemed to be satisfied if the ratio of the exercise price to the fair market value of the shares subject to the stock right immediately after the substitution or assumption is not greater than the ratio of the exercise price to the fair market value of the shares subject to the stock right immediately before the substitution or assumption. In the case of a transaction described in section 355 in which the stock of the distributing corporation and the stock distributed in the transaction are both readily tradable on an established securities market immediately after the transaction, for purposes of this paragraph (b)(5)(v), the requirements of § 1.424-1(a)(5) related to the fair market value of the stock may be satisfied by using market quotations—

(1) Using the last sale before or the first sale after the specified date as of which such valuation is being made, the closing price on the last trading day before or the trading day of a specified date, the arithmetic mean of the high and low prices on the last trading
day before or the trading day of such specified date, or any other reasonable method using actual transactions in such stock as reported by such market on a specified date, for the stock of the distributing corporation and the stock distributed in the transaction as of a predetermined date, provided the specified date is designated before such specified date, and such specified date is not more than 60 days after the transaction or based on an average of such market prices over a predetermined period of not more than 30 days ending not

(2) Using the arithmetic mean of such market prices on trading days during a specified period designated before the beginning of such specified period, where such specified period is not longer than 30 days and ends no later than 60 days after the transaction or

(3) Using an average of such prices during such prespecified period weighted based on the volume of trading of such stock on each trading day during such prespecified period.

(E) Acceleration of date when exercisable. Although with respect to a stock right not immediately exercisable in full, a change in the terms of the right solely to accelerate or delay, within the original term of the stock right, the time at which the stock right (or any portion thereof of such stock right) may be exercised is not a material modification for purposes of this section. With respect to a stock right subject to section 409A, however, such an acceleration may constitute an impermissible acceleration of a payment date under § 1.409A-3(c). Additionally, no modification occurs if a provision accelerating the time when a stock right may first be exercised is removed before the year in which it would otherwise be triggered 1.409A-3(j) or a subsequent deferral under §1.409A2(b).

(F) Discretionary added benefits. If a change to a stock right provides, either by its terms or in substance,
that the holder may receive an additional benefit under the stock right at the future discretion of the grantor, and the addition of such benefit would constitute a modification or extension, then the addition of such discretion is a modification or extension at the time that the stock right is changed to provide such discretion.

(G) Change in underlying stock increasing value. A change in the terms of the stock subject to a stock right that increases the value of the stock is a modification of such stock right, except to the extent that a new stock right is substituted for such stock right by reason of the change in the terms of the stock in accordance with paragraph (b)(5)(v)(D) of this section.

(H) Change in the number of shares purchasable. If a stock right is amended solely to increase the number of shares subject to the stock right, the increase is not considered a modification of the stock right but is treated as the grant of a new additional stock right to which the additional shares are subject. Notwithstanding the previous sentence, if the exercise price and number of shares subject to a stock right are proportionally adjusted to reflect a stock split (including a reverse stock split) or stock dividend, and the only effect of the stock split or stock dividend is to increase (or decrease) on a pro rata basis the number of shares owned by each shareholder of the class of stock subject to the stock right, then there is no modification of the stock right if it is proportionally adjusted to reflect the stock split or stock dividend and the aggregate exercise price of the stock right is not less than the aggregate exercise price before the stock split or stock dividend.

(I) Rescission of changes. Any change to the terms of a stock right (or change in the terms of the plan pursuant to which the stock right was granted or in the terms of any other agreement governing the right) that would inadvertently result in treatment as a modification under paragraph (b)(5)(v)(A) of this section is not considered a modification or extension of the stock right to the extent the change in the terms of the stock right is rescinded by the
earlier of the date the stock right is exercised or the last day of the service provider’s taxable year during which such change occurred. Thus, for example, if the terms of a stock right granted to an individual employee with a calendar year taxable year are changed on March 1 to extend the exercise period in a manner that would result in an extension of the stock right, and the change is rescinded on November 1, then if the stock right is not exercised before the change is rescinded, the stock right is not considered modified under this paragraph (b)(5)(v)(A) of this section.

(J) Successive modifications and extensions. The rules of this paragraph (b)(5)(v) apply as well to successive modifications, including successive extensions or renewals.

(6) Restricted Property

(K) Modifications and extensions in effect on October 23, 2004. For purposes of the application of section 409A and these regulations to a stock right, if a legally binding right to a modification or extension of such stock right existed on October 23, 2004, such modification or extension is disregarded, and the stock right is treated as if granted with the terms and conditions in effect on October 23, 2004.

(vi) Meaning and use of certain terms—(A) Option. The term option means the right or privilege of an individual to purchase stock from a corporation by virtue of an offer of the corporation continuing for a stated period of time, whether or not irrevocable, to sell such stock at a price determined under paragraph (b)(5)(vi)(D) of this section, such individual being under no obligation to purchase. While no particular form of words is necessary, the option must express an offer to sell at the option price, the maximum number of shares purchasable under the option, and the period of time during which the offer remains open. The term option includes a warrant that meets the requirements of this paragraph (b)(5)(vi)(A). An option may be granted as part of or in conjunction with an employee stock purchase plan or subscription contract. An option must be in writing (in paper or electronic form) provided that such writing is adequate to establish an
option right or privilege that is enforceable under applicable law.

(B) Date of grant of option. (1) The language the date of grant of the option, and similar phrases, refer to the date when the granting corporation completes the corporate action necessary to create the legally binding right constituting the option. A corporate action creating the legally binding right constituting the option is not considered complete until the date on which the maximum number of shares that can be purchased under the option and the minimum exercise price are fixed or determinable, and the class of underlying stock and the identity of the service provider is designated. Ordinarily, if the corporate action provides for an immediate offer of stock for sale to a service provider, or provides for a particular date on which such offer is to be made, the date of the granting of the option is the date of such corporate action if the offer is to be made immediately, or the date provided as the date of the offer, as the case may be. However, an unreasonable delay in the giving of notice of such offer to the service provider will be taken into account as indicating that the corporation provided that the offer was to be made at the subsequent date on which such notice is given.

(2) If the corporation imposes a condition on the granting of an option (as distinguished from a condition governing the exercise of the option), such condition generally will be given effect in accordance with the intent of the corporation. However, if the grant of an option is subject to approval by stockholders, the date of grant of the option will be determined as if the option had not been subject to such approval. A condition that does not require corporate action, such as the approval of, or registration with, some regulatory or government agency, for example, a stock exchange or the Securities and Exchange Commission, is ordinarily considered a condition upon the exercise of the option unless the corporate action clearly indicates that the option is not to be granted until such condition has been satisfied.
In general, a condition imposed upon the exercise of an option will not operate to make ineffective the granting of the option. For example, on June 1, 2008, Corporation A grants to X, an employee, an option to purchase 5,000 shares of the corporation’s common stock, exercisable by X on or after June 1, 2009, provided X is employed by the corporation on June 1, 2009, and provided that A’s profits during the fiscal year preceding the year of exercise exceed $200,000. Such an option is granted to X on June 1, 2008, and will be treated as outstanding as of such date.

Stock. The term stock means capital stock of any class, including voting or nonvoting common or preferred stock. Except as otherwise provided, the term stock includes both treasury stock and stock of original issue. Special classes of stock authorized to be issued to and held by employees are within the scope of the term stock for this purpose, provided such stock otherwise possesses the rights and characteristics of capital stock.

Exercise price. The term exercise price means the consideration in cash or property that, pursuant to the terms of the option, is the price at which the stock subject to the option is purchased. The term exercise price does not include any amounts paid as interest under a deferred payment plan or treated as interest.

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

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

(G) Readily tradable. For purposes of this section and §§1.409A-2 through 1.409A-6, stock is treated as readily tradable if it is regularly quoted by brokers or dealers making a market in such stock.

(H) Application to stock appreciation rights. For purposes of this section and §§1.409A-2 through 1.409A-6, the definitions provided in paragraphs (b)(5)(vi)(A) through (G) of this section may be applied by analogy to the issuance of, exercise of, or payment upon the exercise of, a stock appreciation right.

(6) (i) Restricted property, section 402(b) trusts, and section 403(c) annuities-(i) In general. If a service provider receives property from, or pursuant to, a plan maintained by a service recipient, there is no deferral of compensation merely because the value of the property is not includible in income in the year of receipt by reason of the property being substantially nonvested (as defined in § 1.83-3(b)), or is includible in income solely due to a valid election under section 83(b). For purposes of this paragraph (b)(6)(i), a transfer of property includes the transfer of a beneficial interest in a trust or annuity plan, or a transfer to or from a trust or under an annuity plan, to the extent such a transfer is subject to section 83, section 402(b) or section 403(c). In addition, for purposes of this paragraph (b), a right to compensation income that will be required to be included in income under section 402(b)(4)(A) is not a deferral of compensation.
(ii) Promises to transfer property. A plan under which a service provider obtains a legally binding right to receive property (whether or not in a future taxable year where the property will be substantially nonvested (as defined in § 1.83-3(b)) at the time of grant) in a future taxable year where the property will be substantially nonvested may provide for the deferral of compensation and, accordingly, may constitute a nonqualified deferred compensation plan. The vesting of a legally binding right to receive property in a future taxable year where the property will be substantially nonvested property subject to section 83 may be treated as a payment for purposes of section 409A, including for purposes of applying the short-term deferral rules under paragraph (b)(4) of this section. Accordingly, where the promise to (as defined in §1.83-3(b)) at the time of transfer of the substantially nonvested property and the right to retain the substantially nonvested property are both subject to a substantial risk of forfeiture (as defined under paragraph (d) of this section), the arrangement generally would constitute a short-term deferral under paragraph (b)(4) of this section because the payment would occur simultaneously with the vesting of the right to the property. For example, where an employee participates in a two-year bonus program such that, if the employee continues in employment for two years, the employee is entitled to either the immediate payment of a $10,000 cash bonus or the grant of restricted stock with a $15,000 fair market value subject to a vesting requirement of three additional years of service, the arrangement generally would constitute a short-term deferral under paragraph (b)(4) of this section because under either alternative the payment would be received within the short-term deferral period property will not provide for the deferral of compensation and, accordingly, will not constitute a nonqualified deferred compensation plan unless offered in conjunction with another legally binding right that constitutes a deferral of compensation.

(7) Arrangements between partnerships and partners. [Reserved.]

(8) Certain foreign arrangements—

(i) Arrangements Certain foreign plans--(i) Plans with respect to compensation covered by treaty or other international agreement. An arrangement with a service provider participates does not provide for a deferral of compensation for purposes of this paragraph (b) to the extent that the compensation under the arrangement would have been excluded from gross income for Federal income
tax purposes under the provisions of any bilateral income tax convention or other bilateral or multilateral agreement to which the United States is a party if the compensation had been paid to the service provider at the time that the legally binding right to the compensation first arose or, if later, the time that the legally binding right was no longer subject to a substantial risk of forfeiture.

(ii) Arrangements with respect to certain other compensation. An arrangement with a plan in which a service provider participates does not provide for a deferral of compensation for purposes of this paragraph (b) to the extent that compensation under the arrangement would not have been includible in gross income for Federal tax purposes if it had been paid to the service provider at the time that the legally binding right to the compensation first arose or, if later, the time that the legally binding right was no longer subject to a substantial risk of forfeiture, due to one of the following—:

(A) The service provider was a nonresident alien at such time and the compensation would not have been includible in gross income under section 872.

(B) The service provider was a qualified individual (as defined in section 911(d)(1)) at such time and the compensation would have been foreign earned income within the meaning of section 911(b)(1) without regard to section 911(b)(1)(B)(iv) if paid at such time, and the amount of such compensation would have been foreign earned income within the meaning of section 911(b)(1) that was equal to or less than the difference between excess (if any) of the maximum exclusion amount under section 911(b)(2)(D) for such taxable year and the amount of foreign earned income actually excluded from gross income by such qualified individual for such taxable year under section 911(a)(1);

(C) The compensation would have been excludible from gross income under section 893;

(D) The compensation would have been excludible from gross income under section 931 or section 933.

(iii) Tax equalization arrangements. Compensation paid under a tax equalization
arrangement agreement does not provide for a deferral of compensation, provided that any payment if payments made under such arrangement is paid tax equalization agreement are made no later than the end of the second calendar taxable year of the service provider beginning after the calendar taxable year of the service provider in which the service provider’s U.S. Federal income tax return is required to be filed (including extension any extensions) for the year to which the compensation subject to the tax equalization payment relates, or, if later, the second taxable year of the service provider beginning after the latest such taxable year in which the service provider’s foreign tax return or payment is required to be filed or made for the year to which the compensation subject to the tax equalization payment relates. Where such payments arise due to an audit, litigation or similar proceeding, the right to the payments will not be treated as resulting in a deferral of compensation if the payments are scheduled and made in accordance with the provisions of §1.409A-3(i)(1)(v) (timing of tax gross-up payments). For purposes of this paragraph (b)(8)(iii), the term tax equalization arrangement agreement refers to an agreement, method, program, or other arrangement that provides payments intended to compensate the service provider for some or all of the excess of the taxes actually imposed by a foreign jurisdiction on the compensation paid (other than the compensation under the tax equalization agreement) by the service recipient to the service provider over the taxes that would be imposed if the compensation were subject solely to United States Federal income tax, and provided that the payments state, and local income tax, or some or all of the excess of the United States Federal, state, and local income tax actually imposed on the compensation paid by the service to the service provider over the taxes that would be imposed if the compensation were subject solely to taxes in the foreign jurisdiction, provided that the payment made under such agreement, method, program, or other arrangement may not exceed such excess and the amount necessary to compensate for the additional taxes on the amounts amount paid under the agreement, method, program, or other arrangement.

(iv) Certain limited deferrals of a nonresident alien. With respect to a nonresident alien, a foreign plan does not provide for a deferral of compensation if the amounts deferred under the foreign plan based upon services
performed by the nonresident alien in the United States (including amounts deferred based upon service credits or compensation received due to services performed in the United States) do not exceed the applicable dollar amount under section 402(g)(1)(B) for the taxable year. If the amounts deferred under the foreign plan based upon the services performed by the nonresident alien in the United States exceed the applicable dollar amount, an amount of such deferrals equal to such amount is treated as not deferred under a nonqualified deferred compensation plan. For purposes of this paragraph (b)(8)(iv), the term foreign plan means a plan that, together with all substantially similar plans, is maintained by a service recipient for a substantial number of participants, substantially all of whom are nonresident aliens or resident aliens classified as resident aliens solely under section 7701(b)(1)(A)(ii) (and not section 7701(b)(1)(A)(i)).

(v) Additional foreign arrangements—An arrangement with plans. A plan in which a service provider participates does not provide for a deferral of compensation for purposes of this paragraph (b) to the extent designated by the Commissioner in revenue procedures, notices, or other guidance published in the Internal Revenue Bulletin (see § 601.601(d)(2) of this chapter).

(vi) Earnings. Earnings on compensation excluded from the definition of deferral of compensation pursuant to this paragraph (b)(8) are also not treated as a deferred compensation. However, amounts that would be recharacterized as deferred compensation under § 31.3121(v)(2)-1(d)(2)(iii)(B) of this chapter (nonaccount balance plans), § 31.3121(v)(2)-1(d)(2)(iii)(A) of this chapter (account balance plans), or similar principles with respect to plans that are neither nonaccount balance plans nor account balance plans, will not be treated as earnings for purposes of this paragraph (b)(8)(v) deferral of compensation.

(9) Separation pay arrangements—

(i) plans—In general. An arrangement that otherwise provides for a deferral of compensation under this paragraph (b) does not fail to provide a deferral of compensation merely because the right to payment of the compensation is conditioned upon a separation from
service. However, see paragraphs (b)(9)(ii), (iii), (iv), and (v) of this section for provide rules concerning the extent to which certain separation pay arrangements that plans do not provide for the deferral of compensation. The exceptions contained in paragraphs (b)(9)(ii), (iii), (iv), and (v) of this section may be used in combination, such that compensation under a plan that would be excepted under one of those paragraphs may be treated as excepted under another of those paragraphs, so that other compensation under a plan may be treated as excepted under the first of such paragraphs. Notwithstanding any other provision of this paragraph (b)(9), any payment or benefit, or entitlement to a payment or benefit, that acts as a substitute for, or replacement of, amounts deferred by the service recipient under a separate nonqualified deferred compensation plan constitutes a payment or a deferral of compensation under the separate nonqualified deferred compensation plan, and does not constitute a payment or deferral of compensation under a separation pay arrangement. If a service provider receives a payment at separation from service and also has a legally binding right to an amount of deferred compensation that would be forfeited upon the separation from service, whether the payment acts as an acceleration of vesting and substitute payment for the amount of deferred compensation forfeited, or whether the deferred compensation is treated as forfeited and the amount paid is treated as a separate payment of current compensation, is determined based on the facts and circumstances, provided that, where the separation from service is voluntary, it is presumed that the payment results from an acceleration of vesting followed by a payment of the deferred compensation that is subject to section 409A. Accordingly, any change in the payment schedule to accelerate or defer the payments would be subject to the rules of section 409A. The presumption that a right to a payment is not a new right, but is instead a right substituted for a pre-existing forfeited right, may be rebutted by demonstrating that the service provider would have obtained the right to the payment regardless of the forfeiture of the nonvested right. A factor indicating that the service provider would have obtained a right to a payment regardless of the forfeiture of the nonvested right is that the amount to which the service provider obtains a right is materially less than an amount equal to the present value of the forfeited amount multiplied by a fraction, the
numerator of which is the period of service the service provider actually completed, and the denominator of which is the full period of service the service provider would have been required to complete to receive the full amount of the payment. For example, where a service provider is entitled to a future payment only if the service provider completes three years of service and at the time of termination the service provider has completed one year of service, the presumption could be rebutted if the payment to the service provider is materially less than the present value of one-third of the nonvested amount. Another such factor is that the payment to the service provider is of a type customarily made to service providers who separate from service with the service recipient and do not forfeit nonvested rights to deferred compensation (for example, a payment of accrued but unused leave or a payment for a release of actual or potential claims).

(ii) Collectively bargained separation pay arrangements. A separation pay arrangement does not provide for a deferral of compensation if the arrangement extent the plan is a collectively bargained separation pay arrangement that provides for separation pay only upon an actual involuntary separation from service or pursuant to a window program. Only the portion of the separation pay arrangement attributable to employees covered by a bona fide collective bargaining agreement is considered to be provided under a collectively bargained separation pay arrangement. A collectively bargained separation pay arrangement is a separation pay arrangement that meets the following conditions:

(A) The separation pay arrangement is contained within an agreement that the Secretary of Labor determines to be a collective bargaining agreement.

(B) The separation pay provided by the collective bargaining agreement was the subject of arms'-arm's length negotiations between employee representatives and one or more employers, and the agreement between employee representatives and one or more employers satisfies section 7701(a)(46).

(C) The circumstances surrounding the agreement evidence good faith bargaining between adverse
parties over the separation pay to be provided under the agreement.

(iii) Separation pay plans due to involuntary separation from service or participation in a window program. A separation pay plan that is not described in paragraph (b)(9)(ii) of this section and that provides for separation pay only upon an actual involuntary separation from service (as defined in paragraph (n) of this section) or pursuant to a window program does not provide for a deferral of compensation if the plan provides that to the extent that the separation pay, or portion of the separation pay, provided under the plan meets the following requirements:

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

(1) The sum of the service provider’s annualized compensation (as defined in §1.415-1(d)(2)) based upon the annual rate of pay for services provided to the service recipient as an employee and the service provider’s net earnings from self-employment (as defined in section 1402(a)(1)) for services provided to the service recipient as an independent contractor, each for the calendar year preceding the calendar year in which the service provider preceding the taxable year of the service provider in which the service provider has a separation from service (adjusted for any increase during that year that was expected to continue indefinitely if the service provider had not separated from service); or

(2) The maximum amount that may be taken into account under a qualified plan pursuant to section 401(a)(17) for such year; and the year in which the service provider has a separation from service.
(B) The plan provides that the separation pay described in paragraph (b)(9)(iii)(A) of this section must be paid no later than December 31, the last day of the second calendar taxable year of the service provider following the calendar taxable year of the service provider in which occurs the separation from service.

(iv) Reimbursements and certain other separation payments—Foreign separation pay plans. A separation pay plan (including a plan providing payments upon a voluntary separation from service) does not provide for deferred compensation to the extent the plan provides for amounts of separation pay required to be provided under the applicable law of a foreign jurisdiction. For this purpose, a provision of foreign law shall be considered applicable only to foreign earned income (as defined under section 911(b)(1) without regard to section 911(b)(1)(B)(iv) and without regard to the requirement that the income be attributable to services performed during the period described in section 911(d)(1)(A) or (B)) from sources within the foreign country that promulgated such law.

(v) (A) Reimbursements and certain other separation payments—(A) In general. To the extent a separation pay arrangement (including a plan providing payments upon a voluntary separation from service) entitles a service provider to payment by the service recipient for a limited period of time of reimbursements that are not otherwise excludible from gross income, of reimbursements for expenses that the service provider could otherwise deduct under section 162 or section 167 as business expenses incurred in connection with the performance of services (ignoring any applicable limitation based on adjusted gross income), or of reasonable outplacement expenses and reasonable moving expenses actually incurred by the service provider and directly related to the termination of services for the service recipient, such arrangement does not provide for a deferral of compensation. To the extent a separation pay arrangement (including an arrangement involving payments due to a voluntary separation from service) entitles a service provider to reimbursement by the service recipient for a limited period of time of payments of medical expenses incurred and paid by the service provider but not reimbursed and allowable as a deduction under section 213 (disregarding the requirement of
section 213(a) that the deduction is available only to the extent that such expenses exceed 7.5 percent of adjusted gross income), such arrangement does not provide for a deferral of compensation, to the extent such rights apply during a limited period of time (regardless of whether such rights extend beyond the limited period of time). For purposes of this paragraph (b)(9)(v)(A), the reimbursement of reasonable moving expenses includes the reimbursement of all or part of any loss the service provider actually incurs due to the sale of a primary residence in connection with a separation from service.

(B) Medical benefits. To the extent a separation pay plan (including a plan providing payments due to a voluntary separation from service) entitles a service provider to reimbursement by the service recipient of payments of medical expenses incurred and paid by the service provider but not reimbursed by a person other than the service recipient and allowable as a deduction under section 213 (disregarding the requirement of section 213(a) that the deduction is available only to the extent that such expenses exceed 7.5 percent of adjusted gross income), such plan does not provide for a deferral of compensation to the extent such rights apply during the period of time during which the service provider would be entitled (or would, but for such plan, be entitled) to continuation coverage under a group health plan of the service recipient under section 4980B (COBRA) if the service provider elected such coverage and paid the applicable premiums.

(C) In-kind benefits and direct service recipient payments. A service provider’s entitlement to in-kind benefits from the service recipient, or a payment by the service recipient directly to the person providing the goods or services to the service provider, will also be treated as not providing for a deferral of compensation for purposes of this paragraph (b), if a right to reimbursement by the service recipient for a payment for such benefits, goods or services by the service provider would not be treated as providing for a deferral of compensation under this paragraph (b)(9)(iv).
(D) (C) De minimis Limited payments. In addition, if not otherwise excluded, a taxpayer may treat a right or rights under a separation pay arrangement entitles a service provider to reimbursements or other payments or benefits that do not exceed $5,000 in the aggregate, such arrangement does not provide plan to a payment or payments as not providing for a deferral of compensation to the extent such payments in the aggregate do not exceed the applicable dollar amount under section 402(g)(1)(B) for the year of the separation from service.

(E) (D) Limited period of time. For purposes of paragraphs (b)(9)(iv)(A) and (B) of this section, a limited period of time refers to both the period during which applicable expenses may be incurred, and the period during which in-kind benefits may be provided by the service recipient or a third party that the service recipient will pay, does not include periods beyond the last day of the second taxable year of the service provider following the taxable year of the service provider in which the separation occurred, provided that the period during which the reimbursements must be paid, may not extend beyond the December 31 third taxable year of the second calendar year of the service provider in which the separation from service occurred.

(vi) (v) Window programs — definition. The term window program refers to a program established by the service recipient to provide for separation pay in connection with an impending separation from service, to provide separation pay, where such program is made available by the service recipient for a limited period of time (no longer than one year), 12 months, to service providers who separate from service during that period or to service providers who separate from service during that period under specified circumstances. A program will not be considered a window program if a service recipient establishes a pattern of repeatedly providing for similar separation pay in similar situations for substantially consecutive, limited periods of time. Whether the recurrence of these programs constitutes a pattern 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 separation pay relates 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) Plan

(10) Certain indemnification and liability insurance plans. A plan in which a service provider participates does not provide for a deferral of compensation for purposes of this paragraph (b) to the extent that the plan provides (to the extent permissible under applicable law), for the indemnification of, or the purchase of an insurance policy providing for payments of, all or part of the expenses incurred or damages paid or payable by a service provider with respect to a bona fide claim against the service provider or service recipient, including amounts paid or payable by the service provider upon the settlement of a bona fide claim against the service provider or service recipient, where such claim is based on actions or failures to act by the service provider in his or her capacity as a service provider of the service recipient.

(11) Legal settlements. An agreement to which a service provider is a party does not provide for a deferral of compensation for purposes of this paragraph (b) to the extent that the agreement provides for amounts paid as settlements or awards resolving bona fide legal claims based on wrongful termination, employment discrimination, the Fair Labor Standards Act, or worker’s compensation statutes, including claims under applicable Federal, state, local, or foreign laws, or for reimbursements or payments of reasonable attorneys fees or other reasonable expenses incurred by the service provider related to such bona fide legal claims, regardless of whether such settlements, awards, or reimbursement or payment of expenses pursuant to such claims are treated as compensation or wages for Federal tax purposes. Whether the execution of a waiver of any or all of such types of claims indicates that the amounts are paid as an award or settlement of an actual bona fide claim for damages under applicable law is determined based on the facts and circumstances. This paragraph (b)(11) does not apply to any deferred amounts that did not arise as a result of an actual bona fide claim for damages under applicable law, such as amounts that would have been deferred or paid regardless of the existence of such claim, even if such amounts are paid or modified as part of a settlement or award resolving an actual bona fide claim. For this purpose, a provision of foreign law shall be considered applicable only to foreign earned income (as defined under section 911(b)(1) without regard to section 911(b)(1)(B)(iv) and without regard to the requirement that the income be attributable to services performed during the period described in section 911(d)(1)(A) or (B)) from sources within the foreign country that promulgated such law.

(12) Certain educational benefits. A plan in which a service provider participates does not provide for a deferral of compensation to the extent the plan provides for taxable educational benefits. For purposes of this paragraph (b)(12), the
term educational benefits refers solely to benefits provided to a service provider, consisting solely of educational assistance for the education of the service provider, as defined in section 127(c) and the accompanying regulations, and does not refer to any benefits provided for the education of any other person, including any spouse, child, or other family member of the service provider.

(c) Plan--(1) In general. The term plan includes any agreement, method, program, or other arrangement, including an agreement, method, program, or other arrangement that applies to one person or individual. A plan may be adopted unilaterally by the service recipient or may be negotiated or agreed to by the service recipient and one or more service providers or service provider representatives. An agreement, method, program, or other arrangement may constitute a plan regardless of whether it is an employee benefit plan under section 3(3) of the Employee Retirement Income Security Act of 1974 (ERISA), as amended (29 U.S.C. 1002(3)). The requirements of section 409A are applied as if a separate plan or plans is maintained for each service provider. For purposes of determining the terms of a plan, general provisions of the plan that purport to nullify noncompliant plan terms, or to supply any specific plan terms required by this section, §1.409A-2 or §1.409A-3, are disregarded.

(2) Plan aggregation rules--

(i) Plan aggregation rules--(i) In general. Except as otherwise provided in paragraph (c)(2)(ii) of this section, the following rules apply with respect to arrangements between a service provider and a service recipient—the application of this section and

§§1.409A-2 through 1.409A-6 to deferrals of compensation with respect to a service provider:

(A) All amounts deferred with respect to deferrals of compensation at the election of that service provider under all account balance plans of the service recipient (as defined in §31.3121(v)(2)-1(c)(1)(ii)(A) of this chapter) other than a separation pay arrangement that are account balance plans, except to the extent that the plan is described in paragraph (c)(2)(i)(C), (D), (E), (F), (G), or (H) of this section, are treated as deferred under a single plan. For purposes of this paragraph, the term account balance plan means—

(1) An agreement, method, program, or other arrangement that is an account balance plan as defined in §31.3121(v)(2)-1(c)(1)(ii)(A) of this chapter, including mandatorily bifurcating the agreement, method, program,
or other arrangement in accordance with the rules provided in §31.3121(v)-1(c)(1)(iii)(B) of this chapter; or

(2) An agreement, method, program, or other arrangement that would be described in paragraph (c)(2)(i)(A)(1) of this section if the service provider were an employee.

(B) All amounts deferred with respect to that service provider under all nonaccount balance plans of the service recipient (as defined in §31.3121(v)(2)-1(c)(2)(i) of this chapter) other than a separation pay arrangement, are treated as deferred under a single plan. For purposes of this paragraph (c)(2)(i)(B), the term “nonaccount balance plan” means—

(1) An agreement, method, program, or other arrangement that is a nonaccount balance plan as defined in §31.3121(v)(2)-1(c)(2)(i) of this chapter, including mandatorily bifurcating the agreement, method, program, or other arrangement in accordance with the rules provided in §31.3121(v)-1(c)(1)(iii)(B) of this chapter; or

(2) An agreement, method, program, or other arrangement that would be described in

(C) All deferrals of compensation with respect to that service provider under all plans of the service recipient that are nonaccount balance plans, except to the extent such plan is described in paragraph (c)(2)(i)(D), (E), (F), (G), or (H) of this section, are treated as deferred under a single plan. For purposes of this paragraph (c)(2)(i)(C), the term nonaccount balance plan means—

(1) An agreement, method, program, or other arrangement that is a nonaccount balance plan as defined in §31.3121(v)(2)-1(c)(2)(i) of this chapter, including mandatorily bifurcating the agreement, method, program, or other arrangement in accordance with the rules provided in §31.3121(v)-1(c)(1)(iii)(B) of this chapter; or

(2) An agreement, method, program, or other arrangement that would be described in
paragraph (c)(2)(i)(C)(1) of this section if the service provider were an employee.

(D) All amounts deferred deferrals of compensation with respect to that service provider under all separation plans (as defined in paragraph (m) of this section) of the service recipient due to an involuntary termination or to the extent an amount deferred under the plans is not described in paragraph (c)(2)(i)(E) of this section and is payable solely upon an involuntary separation from service within the meaning of paragraph (n) of this section or as a result of participation in a window program, are treated as deferred under a single plan.

(E) All deferrals of compensation with respect to that service provider under all plans of the service recipient to the extent such amounts deferred consist of rights to in-kind benefits or reimbursements of expenses, such as membership fees, or expenses related to aircraft or vehicle usage, to the extent that the right to the in-kind benefit or reimbursement, separately or in the aggregate, does not constitute a substantial portion of either the overall compensation earned by the service provider for performing services for the service recipient or the overall compensation received due to a separation from service, are treated as deferred under a single plan.

(F) All deferrals of compensation with respect to that service provider under all plans of the service recipient to the extent that the taxation of such compensation is governed by §1.61-22 or §1.7872-15 (split-dollar life insurance arrangements), or the taxation of such compensation would be governed by §1.61-22 or §1.7872-15 but for the operation of
§1.61-22(j) (effective date provisions), are treated as deferred under a single plan.

(G) All deferrals of compensation with respect to that service provider under all agreements, methods, programs, or other arrangements of the service recipient to the extent the deferrals under the agreements, methods, programs, or other arrangements are deferrals of amounts that would be treated as modified foreign earned income (meaning foreign earned income as defined under section 911(b)(1) without regard to section 911(b)(1)(B)(iv) and without regard to the requirement that the income be attributable to services performed during the period described in section 911(d)(1)(A) or (B)) if paid to the service provider at the time the amount is first deferred, and provided further that substantially all the participants in such agreements, methods, programs, or other arrangements and any substantially similar agreements, methods, programs, or other arrangements are nonresident aliens and that the service provider does not participate in a substantially identical agreement, method, program, or other arrangement that does not meet the requirements of this paragraph (c)(2)(i)(G) (a domestic arrangement), are treated as deferred under a single plan.

(H) All deferrals of compensation with respect to that service provider under all plans of the service provider to the extent such plans are stock rights (as defined in paragraph (c)(2)(l) of this section) subject to section 409A, are treated as deferred under a single plan.

(I) All deferrals of compensation with respect to that service provider under all plans of the service recipient to the extent such plans are not described in paragraph (c)(2)(i)(A), (B), (C), (D), (E), (F), (G), or (H) of this section are treated as deferred under a single plan.

(ii) Dual status. Arrangements, methods, programs, and other arrangements in which a service provider participates are not aggregated with other agreements, methods, programs, and other arrangements
to the extent the service provider participates in one set of arrangements due to status as an employee of the service recipient (employee arrangements) and another set of arrangements due to status as an independent contractor of the service recipient (independent contractor arrangements). For example, where a service provider deferred amounts under an independent contractor arrangement while providing services as an independent contractor, and then becomes eligible for and defers amounts under a separate employee arrangement after being hired as an employee, the two arrangements will not be aggregated for purposes of this paragraph (c)(2). Where an employee also serves as a director of the service recipient (or a similar position with respect to a non-corporate service recipient), the arrangements under which the employee participates as a director of the service recipient (director arrangements) are not aggregated with employee arrangements, provided that the director arrangements are substantially similar to arrangements provided to service providers providing services only as directors (or similar positions with respect to non-corporate service recipients). For example, an employee director who participates in an employee arrangement and a director arrangement generally may treat the two arrangements as separate plans, provided that the director arrangement is substantially similar to an arrangement providing benefits to a non-employee director. Director arrangements are aggregated for purposes of this paragraph (c)(2).

(3) Establishment of arrangement—

   (i) Plan—(i) In general. To satisfy the requirements of section 409A, an arrangement must be established and maintained by a service recipient, in both form and operation, in accordance with the requirements
of §409A and these regulations, §§1.409A-2 through 1.409A-3 and §§1.409A-5 through 1.409A-6.

For purposes of this paragraph (c)(3), an arrangement plan is established on the latest of the date on which it is adopted, the date on which it is effective, and the date on which the material terms of the plan are set forth in writing. The material terms of the plan may be set forth in writing in one or more documents. For purposes of this paragraph (c)(3)(i), an arrangement plan 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 arrangement plan include the amount (or the method or formula for determining the amount) of deferred compensation to be provided under the arrangement plan and the time when it will be paid and form of payment. Notwithstanding the foregoing, an arrangement plan will be deemed to be established as of the date the participant obtains a legally binding right to deferral of compensation, provided that the arrangement plan is otherwise established under the rules of this paragraph (c)(3)(i) by the end of the calendar taxable year of the service provider in which the legally binding right arises, or with respect to an amount not payable in the year immediately following the taxable year of the service provider in which the legally binding right arises (the subsequent year), the 15th day of the third month of the subsequent year.

(ii) Initial deferral election provisions. If a plan provides a service provider or a service recipient with an initial deferral election, the plan satisfies the requirements of this paragraph (c)(3) if the plan sets forth in writing, on or before the date the applicable election is required to be irrevocable to satisfy the requirements of §1.409A-2(a), the conditions under which such election may be made.

(iii) Subsequent deferral election provisions. If a plan permits a subsequent deferral election described in §1.409A-2(b), the plan satisfies the requirements of this paragraph (c)(3) if the plan sets forth in writing, on or before the date the election is required to be irrevocable to meet the requirements of §1.409A-2(b), the conditions under which such election may be made.

(iv) Payment accelerations. Except as explicitly provided in §1.409A-3, a plan is not required to set forth in writing
the conditions under which a payment may be accelerated if such acceleration is permitted under §1.409A-3(j)(4).

(v) Six-month delay for specified employees. A plan must provide that distributions to a specified employee may not be made before the date that is six months after the date of separation from service or, if earlier, the date of death (the six-month delay rule). The six-month delay rule, required for payments due to the separation from service of a specified employee, must be written in the plan. A plan does not fail to be established and maintained merely because it does not contain the six-month delay rule when the service provider who has a right to compensation deferred under such plan is not a specified employee. However, such provision must be set forth in writing on or before the date such service provider first becomes a specified employee. In general, this means the provision must be set forth in writing on or before the specified employee effective date (as defined in paragraph (i)(3) of this section) for the first list of specified employees that includes such service provider.

(vi) (ii) Amendments to the arrangement. Plan amendments. In the case of an amendment that increases the amount deferred under an arrangement providing for the deferral of a nonqualified deferred compensation plan, the arrangement is not considered established with respect to the additional amount deferred until the arrangement, as amended, is established in accordance with paragraph (c)(3)(i) of this section.

(vii) (iii) Transition rule for written plan requirement. For purposes of this section, a legally enforceable unwritten arrangement that was adopted and effective before December 31, 2006, is treated as established under this section as of the later of the date on which it was adopted or became effective, provided that the material terms of the arrangement are set forth in writing on or before December 31, 2006.

(viii) (iv) Plan aggregation rules. The plan aggregation rules of paragraph (c)(2)(i) of this section do not apply to the requirements of paragraph (c)(3)(i) and (ii) of this section. Accordingly, deferrals of compensation under an agreement, method, program, or other arrangement that fails to meet the requirements of section 409A solely due to a failure to meet the requirements of
this paragraph (c)(3)(i) or (ii) is not aggregated with deferrals of compensation under other agreements, methods, programs, or other arrangements that meet such requirements.

(d) Substantial risk of forfeiture

(d) (1) Substantial risk of forfeiture—(1) In general. Compensation is subject to a substantial risk of forfeiture if entitlement to the amount is conditioned on the performance of substantial future services by any person or the occurrence of a condition related to a purpose of the compensation, and the possibility of forfeiture is substantial. For purposes of this paragraph (d), a condition related to a purpose of the compensation must relate to the service provider’s performance for the service recipient or the service recipient’s business activities or organizational goals (for example, the attainment of a prescribed level of earnings, or equity value or completion of an initial public offering). Any addition of a substantial risk of forfeiture after the legally binding right to the compensation arises, or any extension of a period during which compensation is subject to a substantial risk of forfeiture if the possibility of forfeiture is substantial. An amount is not subject to a substantial risk of forfeiture merely because the right to the amount is conditioned, directly or indirectly, upon the refraining from the performance of services. For purposes of section 409A, an amount will not be considered subject to a substantial risk of forfeiture beyond the date or time at which the recipient otherwise could have elected to receive the amount of compensation, unless the present value of the amount subject to a substantial risk of forfeiture (ignoring earnings, disregarding, in determining the present value, the risk of forfeiture) is materially greater than the present value of the amount the recipient otherwise could have elected to receive absent such risk of forfeiture. For this purpose, compensation that the service provider would receive for continuing to perform services regardless of whether the service provider elected to receive the amount that is subject to a substantial risk of forfeiture is not taken into account in determining whether the present value of the right to the amount subject to a substantial risk of forfeiture is materially greater than the amount the recipient otherwise could have elected to receive absent such risk of forfeiture. For example, a salary deferral generally may not be made subject to a substantial risk of forfeiture. But, for example, where a bonus arrangement plan provides an election between a cash payment of a certain amount or restricted stock units with a present value that is materially greater value (disregarding the risk of forfeiture) than the present value of such cash payment and that will be forfeited absent continued services...
for a period of years, the right to the restricted stock units generally will be treated as subject to a substantial risk of forfeiture.

(2) Stock rights. A stock right will be treated as not subject to a substantial risk of forfeiture at the earlier of the first date the holder may exercise the stock right and receive cash or property that is substantially vested (as defined in §1.83–31.833(b)) or the first date that the stock right is not subject to a forfeiture condition that would constitute a substantial risk of forfeiture. Accordingly, a stock option that the service provider may exercise immediately and receive substantially vested stock will be treated as not subject to a substantial risk of forfeiture, even if the stock option automatically terminates upon the service provider’s separation from service.

(3) Enforcement of forfeiture condition—

(i) Enforceability of forfeiture condition—(i) In general. In determining whether the possibility of forfeiture is substantial in the case of rights to compensation granted by a service recipient to a service provider that owns a significant amount of the total combined voting power or value of all classes of equity of the service recipient or of its parent (where the service provider’s ownership is determined with application of the attribution rules under section 318 if the service recipient is a corporation, or if the service recipient is an entity that is not a corporation, with application by analogy of the attribution rules under section 318), all relevant facts and circumstances will be taken into account in determining whether the probability of the service recipient enforcing such condition is substantial, including—

(A) The service provider’s relationship to other equity holders and the extent of their control, potential control and possible loss of control of the service recipient;

(B) The position of the service provider in the service recipient and the extent to which the service provider is subordinate to other service providers;

(C) The service provider’s relationship to the officers and directors of the service recipient (or similar positions with respect to a noncorporate service recipient);

(D) The person or persons who must approve the service provider’s discharge; and

(E) Past actions of the service recipient in enforcing the restrictions.

(ii) Examples. The following examples illustrate the rules of paragraph (d)(3)(i) of this section:
Example 1. A service provider would be considered as having deferred compensation subject to a substantial risk of forfeiture, but for the fact that the service provider owns 20 percent of the single class of stock in the transferor corporation. If the remaining 80 percent of the class of stock is owned by an unrelated individual (or members of such an individual’s family) so that the possibility of the corporation enforcing a restriction on such rights is substantial, then such rights are subject to a substantial risk of forfeiture.

Example 2. A service provider would be considered as having deferred compensation subject to a substantial risk of forfeiture, but for the fact that the service provider, who is president of the corporation, also owns 4 percent of the voting power of all the stock of a corporation. If the remaining stock is so diversely held by the public that the president, in effect, controls the corporation, then the possibility of the corporation enforcing a restriction on the right to deferred compensation of the president is not substantial, and such rights are not subject to a substantial risk of forfeiture.

(e) --- Performance-based compensation ---

(e)(1) Performance-based compensation -- In general. The term performance-based compensation means compensation where the amount of which, or the entitlement to which, the compensation is contingent on the satisfaction of preestablished organizational or individual performance criteria relating to a performance period of at least 12 consecutive months in which the service provider performs services. Organizational or individual performance criteria are considered preestablished if established in writing by not later than 90 days after the commencement of the period of service to which the criteria relates, provided that the outcome is substantially uncertain at the time the criteria are established. Performance-based compensation may include payments based on performance criteria that are not approved by a compensation committee of the board of directors (or similar entity in the case of a non-corporate service recipient) or by the stockholders or members of the service recipient. Notwithstanding the foregoing, performance-based compensation does not include any amount or portion of any amount that will be paid either regardless of performance, or based upon a level of performance that is substantially certain to be met at the time the criteria is established. Except as provided in paragraph (e)(3) of this section, compensation is not performance-based compensation merely because the amount of such compensation is determined by reference to the value of, or increase in the value of, the service recipient or the stock of the service recipient. Where a portion of an amount of compensation would qualify as performance-based compensation if the portion were the sole amount available under the plan, that portion of the award will not fail to qualify as performance-based compensation if that portion is designated separately or otherwise separately identifiable under the terms of the plan, and the amount of each portion is determined independently of the other. Compensation may be performance-based compensation where the amount will be paid regardless of satisfaction of the performance criteria due to the service provider’s death, disability, or a change in control event (as defined in §1.409A-3(i)(5)(i)), provided that a payment made under such circumstances without regard to the satisfaction of the performance criteria will not constitute performance-based compensation. For purposes
of this paragraph (e)(1), a disability refers to any medically determinable physical or mental impairment resulting in the service provider’s inability to perform the duties of his or her position or any substantially similar position, where such impairment can be expected to result in death or can be expected to last for a continuous period of not less than six months.

(2) Payments based upon subjective performance criteria. The term performance-based compensation may include payments based upon subjective performance criteria, provided that—

(i) The subjective performance criteria are bona fide and relate to the performance of the participant service provider, a group of service providers that includes the participant service provider, or a business unit for which the participant service provider provides services (which may include the entire organization); and

(ii) The determination that any subjective performance criteria have been met is not made by the participant service provider or a family member of the participant service provider (as defined in section 267(c)(4) applied as if the family of an individual includes the spouse of any member of the family), or a person under the supervision of the participant service provider or such a family member, or where any amount of the compensation of the person making such determination is effectively controlled in whole or in part by the service provider or such a family member.

(3) Equity-based compensation. Compensation is performance-based compensation if it is based solely on an increase in the value of the service recipient, or a share of stock of the service recipient, after the date of a grant or award. If the amount of compensation the service provider will receive under a grant or award is not based solely on an increase in the value of the service recipient, or stock of the service recipient, after the date of the grant or award (for example, a stock appreciation right granted with an exercise price that is less than the fair market value of the stock as of the date of grant), and that other amount would not otherwise qualify as performance-based compensation, the compensation attributable to the grant or award does not qualify as performance-based compensation. Notwithstanding the foregoing, the attainment of a prescribed value for the service recipient (or a portion thereof), or a share of stock in the service recipient, may be used as a preestablished organizational criterion for purposes of providing performance-based compensation, provided that the other requirements of paragraph (e)(1) of this section are satisfied. In addition, an award of equity-based compensation may constitute performance-based compensation if entitlement to the compensation is subject to a
condition that would cause the award to otherwise qualify as performance-based compensation, such as a performance-based vesting condition. The eligibility of a service provider to defer compensation under an equity-based compensation award that would be realized upon the exercise of a stock right generally constitutes an additional deferral feature with respect to the award for purposes of the definition of a deferral of compensation under paragraph (b)(5) of this section.

(f) Service provider—

(1) In general. The term service provider includes—

(i) An individual, corporation, subchapter S corporation or partnership;

(ii) A partnership, personal service corporation (as defined in section 269A(b)(1)), or a noncorporate entity that would be a personal service corporation if it were a corporation; or

(iii) A qualified personal service corporation (as defined in section 448(d)(2)), or a noncorporate entity that would be a qualified personal service corporation if it were a corporation, for any taxable year in which such individual, corporation, subchapter S corporation, partnership, or other entity accounts for gross income from the performance of services under the cash receipts and disbursements method of accounting. The term service provider generally includes a person who has separated from service (a former service provider).

(2) Service providers using an accrual method of accounting. Section 409A does not apply to a deferral under an arrangement between taxpayers if, for the taxable year in which the service provider taxpayer obtains a legally binding right to the compensation, the service provider uses an accrual method of accounting for Federal tax purposes.

(3) Independent contractors—

(i) Independent contractors. Except as otherwise provided in paragraph (f)(3)(iv) of this section, section 409A does not apply to an amount deferred under an arrangement between a service provider and service recipient with respect to a particular trade or business in which the service provider participates, including earnings credited to such deferred amount, if during the service provider’s taxable year in which the service provider obtains a legally binding right to the payment of the amount deferred—each of the following applies:

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

(B) The service provider provides significant services to two or more service recipients to which the service provider is not related and that are not related to one another (as defined in paragraph (f)(32)(ii) of this section).

(C) The service provider is not related to the service recipient, applying the definition of related person contained in paragraph (f)(32)(ii) of this section subject to the modification that the language “50 percent” is not used instead of “20 percent” each place it appears in sections 267(b)(1) and 707(b)(1).

(ii) Related person. For purposes of this paragraph (f)(32), a person is related to another person if the persons bear a relationship to each other that is specified in section 267(b) or 707(b)(1), subject to the modifications that the language “20 percent” is used instead of “50 percent” each place it appears in sections 267(b) and 707(b)(1), and section 267(c)(4) is applied as if the family of an individual includes the spouse of any member of the family; or the persons are engaged in trades or businesses under common control (within the meaning of section 52(a) and (b)). In addition, an individual is related to an entity if the individual is an officer of an entity that is a corporation, or holds a position substantially similar to an officer of a corporation with an entity that is not a corporation.

(iii) Significant services. Whether a service provider is providing significant services depends on the facts and circumstances of each case. However, for purposes of paragraph (f)(32)(i) of this section, a service provider who provides services to two or more service recipients to which the service provider is not related and that are not related to one another is deemed to be providing significant services to two or more of such service recipients for a given taxable year, if the revenues generated from the services provided to any service recipient or group of related service recipients during such taxable year do not exceed 70 percent of the total revenue generated by the service provider from the trade or
business of providing such services. In addition, in the case of a service provider who has been providing services in a trade or business for a period of not less than three consecutive years, for purposes of paragraph (f)(2)(i) of this section, a service provider who provides services to two or more service recipients to which the service provider is not related and that are not related to one another is deemed to be providing significant services to two or more of such service recipients for a given taxable year if in each of the prior three taxable years the revenues generated from the services provided to any service recipient or group of related service recipients during such prior taxable years did not exceed 70 percent of the total revenue generated by the service provider from the trade or business of providing such services and, at the time an amount is deferred, the service provider does not know or have reason to anticipate that the revenues generated from the services provided to any service recipient or group of related service recipients during the current year will exceed 70 percent of the total revenue generated by the service provider from the trade or business of providing such services.

(iv) Management services. AThis paragraph (f)(2) does not apply to a service provider is treated as related to a service recipient for purposes of paragraph (f)(3)(i) of this section if to the extent the service provider provides management services to the a service recipient. For purposes of this paragraph (f)(3)(iv), the term management services means services that involve the actual or de facto direction or control of the financial or operational aspects of a trade or business of the service recipient, or investment management or advisory services provided to a service recipient whose primary trade or business includes the management investment of financial assets (including investments in real estate) for its own account, such as a hedge fund or a real estate investment trust.

(v) Services provided to related persons. Section 409A does not apply to an amount deferred under a plan that is a bona fide agreement, method, program, or other arrangement between a service provider and a related service recipient arising in the ordinary course of a particular trade or business in which the service provider is engaged to the extent that-
(A) The service provider provides services to the service recipient as an independent contractor;

(B) During the service provider’s taxable year in which the amount is deferred, the service provider qualifies for the safe harbor provided in paragraph (f)(2)(iii) of this section with respect to such trade or business; and

(C) Such agreement, method, program, or other arrangement and the practices thereunder (including billing and collection practices), are substantially similar to the agreements, methods, programs, or other arrangements and practices applicable to one or more unrelated service recipients to whom the service provider provides substantial services and that produce a majority of the total revenue that the service provider earns from the trade or business of providing such services during the taxable year.

(g) Service recipient. Except as otherwise specifically provided in these regulations, the term service recipient means the person for whom the services are performed and with respect to whom the legally binding right to compensation arises, and all persons with whom such person would be considered a single employer under section 414(b) (employees of controlled group of corporations), and all persons with whom such person would be considered a single employer under section 414(c) (employees of partnerships, proprietorships, etc., under common control). For example, where the service provider is an employee, the service recipient generally is the employer (including all persons treated as a single employer under section 414(b) or (c)). Notwithstanding the foregoing, section 409A applies to a plan that provides for the deferral of compensation, even if the payment of the compensation is not made by the person for whom services are performed.

(h) Separation from service—

(1) Employees—

(i) In general. An employee separates from service with the service recipient—employer if the employee dies, retires, or otherwise has a termination of employment with the employer. However, for purposes of this paragraph (h)(1), the employment relationship is treated as continuing intact while the individual is on military leave, sick leave, or other bona fide leave of absence (such as temporary employment by the government) if the period of such leave does not exceed six months, or if longer, so long as the individual’s right to reemployment
with the service recipient is provided either by statute or by contract, under an applicable statute or by contract. For purposes of this paragraph (h)(1), a leave of absence constitutes a bona fide leave of absence only if there is a reasonable expectation that the employee will return to perform services for the employer. If the period of leave exceeds six months and the individual does not retain a right to reemployment is not provided either by statute or by contract, the employment relationship is deemed to terminate on the first date immediately following such six-month period.

Notwithstanding the foregoing, where a leave of absence is due to any medically determinable physical or mental impairment that can be expected to result in death or can be expected to last for a continuous period of not less than six months, where such impairment causes the employee to be unable to perform the duties of his or her position of employment or any substantially similar position of employment, a 29-month period of absence may be substituted for such six-month period.

(ii) Termination of employment. Whether a termination of employment has occurred is determined based on whether the facts and circumstances indicate that the employer and employee reasonably anticipated that no further services would be performed after a certain date or that the level of bona fide services the employee would perform after such date (whether as an employee or as an independent contractor) would permanently decrease to no more than 20 percent of the average level of bona fide services performed (whether as an employee or an independent contractor) over the immediately preceding 36-month period (or the full period of services to the employer if the employee has been providing services to the employer less than 36 months). Facts and circumstances to be considered in making this determination include, but are not limited to, whether the employee continues to be treated as an employee for other purposes (such as continuation of salary and participation in employee benefit programs), whether similarly situated service providers have been treated consistently, and whether the employee is permitted, and realistically available, to perform services for other service recipients in the same line of business. An employee is presumed to have separated from service where the level of bona fide services performed decreases to a level equal to 20 percent or less of the average level of services performed
by the employee during the immediately preceding 36-month period. An employee will be presumed not to have separated from service where the level of bona fide services performed continues at a level that is 50 percent or more of the average level of service performed by the employee during the immediately preceding 36-month period. No presumption applies to a decrease in the level of bona fide services performed to a level that is more than 20 percent and less than 50 percent of the average level of bona fide services performed during the immediately preceding 36-month period. The presumption is rebuttable by demonstrating that the employer and the employee reasonably anticipated that as of a certain date the level of bona fide services would be reduced permanently to a level less than or equal to 20 percent of the average level of bona fide services provided during the immediately preceding 36-month period or full period of services provided to the employer if the employee has been providing services to the service recipient for a period of less than 36 months (or that the level of bona fide services would not be so reduced). For example, an employee may demonstrate that the employer and employee reasonably anticipated that the employee would cease providing services, but that, after the original cessation of services, business circumstances such as termination of the employee’s replacement caused the employee to return to employment. Although the employee’s return to employment may cause the employee to be presumed to have continued in employment because the employee is providing services at a rate equal to the rate at which the employee was providing services before the termination of employment, the facts and circumstances—Where an employee either actually or purportedly continues in the capacity as an employee, such as through the execution of an employment agreement under which the employee agrees to be available to perform services if requested, but the facts and circumstances indicate that the employer and the employee did not intend for the employee to provide more than insignificant services for the employer, an employee will be treated as having a
For purposes of the preceding sentence, an employer and employee will not be treated as having intended for the employee to provide insignificant services where the employee continues to provide services as an employee at an annual rate that is at least equal to 20 percent of the services rendered, on average, during the immediately preceding three full calendar years of employment (or, if employed less than three years, such lesser percent of the average annual remuneration earned during the final three full occurred for purposes of this paragraph (h)(1) if the former employee is providing services at an annual rate that is 50 percent or more of the services rendered, on average, during the immediately preceding three full calendar years of employment (or if employed less than three years, such lesser period) and the annual remuneration for such services is 50 percent or more of the annual remuneration earned during the final three full calendar years of employment (or if less, such lesser period). For purposes of this paragraph (h)(1)(ii), the annual rate of providing services is determined based upon the measurement used to determine the service provider’s base compensation (for example, amounts of time required to earn salary, hourly wages, or payments for specific projects), in this case would demonstrate that at the time the employee originally ceased to provide services, the employee and the service recipient reasonably anticipated that the employee would not provide services in the future. Notwithstanding the foregoing provisions of this paragraph (h)(1)(ii), a plan may treat another level of reasonably anticipated permanent reduction in the level of bona fide services as a separation from service, provided that the level of reduction required must be designated in writing as a specific percentage, and the reasonably anticipated reduced level of bona fide services must be greater than 20 percent but less than 50 percent of the average level of bona fide services provided in the immediately preceding 12 months. The plan must specify the definition of separation from service on or before the date on which a separation from service is designated as a time of payment of the applicable amount deferred, and once designated, any change to the definition of separation from service with respect to such amount deferred will be subject to the rules regarding subsequent deferrals and the
acceleration of payments. For purposes of this paragraph (h)(1)(ii), for periods during which an employee is on a paid bona fide leave of absence (as defined in paragraph (h)(1)(i) of this section) and has not otherwise terminated employment pursuant to paragraph (h)(1)(i) of this section, the employee is treated as providing bona fide services at a level equal to the level of services that the employee would have been required to perform to receive the compensation paid with respect to such leave of absence. Periods during which an employee is on an unpaid bona fide leave of absence (as defined in paragraph (h)(1)(i) of this section) and has not otherwise terminated employment pursuant to paragraph (h)(1)(i) of this section, are disregarded for purposes of this paragraph (h)(1)(ii) (including for purposes of determining the applicable 36-month (or shorter) period).

(2) Independent contractors—

(i) In general. An independent contractor is considered to have a separation from service with the service recipient upon the expiration of the contract (or in the case of more than one contract, all contracts) under which services are performed for the service recipient if the expiration constitutes a good-faith and complete termination of the contractual relationship. An expiration does not constitute a good faith and complete termination of the contractual relationship if the service recipient anticipates a renewal of a contractual relationship or the independent contractor becoming an employee. For this purpose, a service recipient is considered to anticipate the renewal of the contractual relationship with an independent contractor if it intends to contract again for the services provided under the expired contract, and neither the service recipient nor the independent contractor has eliminated the independent contractor as a possible provider of services under any such new contract. Further, a service recipient is considered to intend to contract again for the services provided under an expired contract if the service recipient’s doing so is conditioned only upon incurring a need for the services, the availability of funds, or both.

(ii) Special rule. Notwithstanding paragraph (b)(2)(i) of this section, the plan is considered to satisfy the requirement described in paragraph (a) of this section that no amounts deferred under the plan be paid or made available to the
§1.409A-3 (a)(1) with respect to an amount payable upon a separation from service with the service recipient if, with respect to amounts payable to a participant who is an independent contractor, the plan provides that—

(A) No amount will be paid to the participant before a date at least 12 months after the day on which the contract expires under which the service provider performs services for the service recipient (or, in the case of more than one contract, all such contracts expire); and

(B) No amount payable to the participant on that date will be paid to the participant if, after the expiration of the contract (or contracts) and before that date, the participant performs services for the service recipient as an independent contractor or an employee.

(i) Specified employee

(3) Definition of service recipient and employer. For purposes of this paragraph (h), the term service recipient or employer means the service recipient as defined in paragraph (g) of this section, provided that in applying section 1563(a)(1), (2), and (3) for purposes of determining a controlled group of corporations under section 414(b), the language “at least 50 percent” is used instead of “at least 80 percent” each place it appears in section 1563(a)(1), (2), and (3), and in applying §1.414(c)-2 for purposes of determining trades or businesses (whether or not incorporated) that are under common control for purposes of section 414(c), “at least 50 percent” is used instead of “at least 80 percent” each place it appears in §1.414(c)-2. A plan may provide with respect to a deferral of compensation under the plan that in applying sections 1563(a)(1), (2), and (3) for purposes of determining a controlled group of corporations under section 414(b), another defined percentage greater than 50 percent, but not greater than 80 percent, is used instead of “at least 80 percent” at each place it appears in sections 1563(a)(1), (2), and (3), and in applying §1.414(c)-2 for purposes of determining trades or businesses (whether or not incorporated) that are under common control for purposes of section 414(c), another defined percentage greater than 50 percent, but not greater than 80 percent, is used instead of “at least 80 percent” at each place it appears in §1.414(c)-2. In addition, where the use of such definition of service recipient for purposes of determining a separation from service is based upon legitimate business criteria, the plan may provide that for purposes of a deferral of compensation under the plan that in applying sections 1563(a)(1), (2), and (3) for purposes of determining a controlled group of corporations under section 414(b), the language “at least 20 percent” or another defined percentage not less than 20 percent but not greater than 50 percent is used instead of “at least 80 percent” at each place it appears in sections 1563(a)(1), (2), and (3), and in
applying §1.414(c)-2 for purposes of determining trades or businesses (whether or not incorporated) that are under common control for purposes of section 414(c), the language “at least 20 percent” or another defined percentage not less than 20 percent but not greater than 50 percent is used instead of “at least 80 percent” at each place it appears in §1.414(c)-2. Where a definition of service recipient or employer other than the definition provided in the first sentence of this paragraph (h)(3) (the 50 percent standard) is used, the plan must designate in writing the alternate definition no later than the last date at which the time and form of payment of the applicable amount deferred must be elected in accordance with §1.409A-2(a), and any change in the definition for such amounts deferred will constitute a change in the time and form of payment subject to the rules governing subsequent deferral elections under §1.409A-2(b) and the acceleration of payments under §1.409A3(j).

(4) Asset purchase transactions. Where as part of a sale or other disposition of assets by one service recipient (seller) to an unrelated service recipient (buyer), a service provider of the seller would otherwise experience a separation from service with the seller, the seller and the buyer may retain the discretion to specify, and may specify, whether a service provider providing services to the seller immediately before the asset purchase transaction and providing services to the buyer after and in connection with the asset purchase transaction has experienced a separation from service for purposes of this paragraph (h), provided that the asset purchase transaction results from bona fide, arm’s length negotiations, all service providers providing services to the seller immediately before the asset purchase transaction and providing services to the buyer after and in connection with the asset purchase transaction are treated consistently (regardless of position at the seller) for purposes of applying the provisions of any nonqualified deferred compensation plan, and such treatment is specified in writing no later than the closing date of the asset purchase transaction. For purposes of this paragraph (h)(4), references to a sale or other disposition of assets, or an asset purchase transaction, refer only to a transfer of substantial assets, such as a plant or division or substantially all the assets of a trade or business. For purposes of this paragraph (h)(4), whether a service recipient is related to another service recipient is determined under the rules provided in paragraph (f)(2)(ii) of this section.

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

(6) Collectively bargained plans covering multiple employers. Notwithstanding the foregoing provisions of this paragraph (h), to the extent a plan is established pursuant to a bona fide collective bargaining agreement covering services performed by employees for multiple employers, such plan may define a separation from service in a reasonable manner that treats the employee as not having separated from service during periods in which the employee is not providing services but is available to perform services covered by the collective bargaining agreement for one or more employers, provided that the definition also provides that the employee must be deemed to have separated from service at a specified date not later than the end of any period of at least 12 consecutive months during which the employee has not provided any services covered by the collective bargaining agreement for one or more employers. This paragraph (h)(6) applies only if the definition of separation from service provided by the collective bargaining agreement was the subject of arm’s length negotiations between employee representatives and two or more employers, the agreement between employee representatives and such employers satisfies section 7701(a)(46), and the circumstances surrounding the agreement evidence good faith bargaining between adverse parties over such definition.

(i) Specified employee--(1) In general. The term specified employee means a service provider who, as of the date of the service provider’s separation from service, is a key employee (as defined in section 416(i) without regard to section 416(i)(5)) of a service recipient any stock of which is publicly traded on an established securities market or otherwise. For purposes of this paragraph (i)(1), an employee service provider is a key employee if the employee service provider meets the requirements of section 416(i)(1)(A)(i), (ii), or (iii) (applied in accordance with the regulations thereunder and disregarding section 416(i)(5)) at any time during the 12-month period ending on an identification date. If a person service provider is a key employee as of an identification date, the person service provider is treated as a specified key employee for the purposes of this paragraph (i) for the entire 12-month period beginning on the first day of the fourth month following the identification date. A service recipient may designate any date in a calendar year as the identification date provided that a service recipient must use the same identification date with respect to all arrangements, and any change to the identification date may not be effective for a period of 12 months. If no identification date is designated, the identification date is December 31. The service recipient may designate an identification date through inclusion in each plan document or through a
separate document, provided that the service recipient will not be treated as having designated an identification date on any date before the execution of the document containing the designation. Notwithstanding the foregoing, any designation of an identification date made on or before December 31, 2006, may be applied to any separation from service occurring on or after January 1, 2005. Whether any stock of a service recipient is publicly traded on an established securities market or otherwise must be determined as of the date of the employee’s separation from service specified.

(2) **Spinoffs and mergers.** Where a new corporation or entity (new corporation) is established as part of a corporate division governed by section 355 from a corporation that is publicly traded on an established securities market or otherwise (old corporation), any employee of the new corporation who was a key employee of the old corporation immediately prior to the spinoff is a key employee of the new corporation until the end of the 12-month period beginning on the first day of the fourth month following the old corporation’s last identification date preceding the spinoff transaction. Where two corporations (pre-merger corporations) are merged or become part of the same controlled group of corporations so as to be treated as a single service recipient under paragraph (g) of this section, any employee of the merged corporation who was a key employee of either of the pre-merger corporations immediately before the merger is a key employee of the merged corporation until the first day of the fourth month after the identification date of the merged corporation next following the merger.

**Definition of compensation.** For purposes of identifying a specified employee by applying the requirements of section 416(i)(1)(A)(i), (ii), and (iii), the definition of compensation under §1.415(c)-2(a) is used, applied as if the service recipient were not using any safe harbor provided in §1.415(c)-2(d), were not using any of the special timing rules provided in §1.415(c)-2(e), and were not using any of the special rules provided in §1.415(c)-2(g). Notwithstanding the foregoing, a service recipient may elect to use any available definition of compensation under section 415 and the regulations thereunder in accordance with the election requirements set forth in paragraph (i)(8) of this section, including any available safe harbor and any available election under the timing rules or special rules, provided that the definition is applied consistently to all employees of the service recipient for purposes of identifying specified employees. A service recipient may elect to use such an alternative definition regardless of whether another definition of compensation is being used for purposes of a qualified plan sponsored by the service recipient. However, once a list of specified employees has become effective, the service recipient cannot change the definition of compensation for purposes of identifying specified employees for the period with respect to which such list is effective.

(3) **Specified employee identification date.** Unless another date is designated in accordance with the requirements of this paragraph (i)(3) and paragraph (i)(8) of this section, the specified employee identification date is December 31. A service recipient may designate in accordance with the requirements of paragraph (i)(8) of this section any other date as the specified employee identification date, provided that a service recipient must use the same specified employee identification date with respect to all nonqualified deferred compensation plans, and any change to the specified employee identification date may not be effective for a period of at least 12 months.
service recipient may designate a specified employee identification date in each plan or in a separate document applicable to all plans, provided that the service recipient will not be treated as having designated a specified employee identification date before the designation is legally binding on the service recipient and all affected service providers. Any designation of a specified employee identification date made on or before December 31, 2007, may be applied to any separation from service occurring on or after January 1, 2005, unless and until subsequently changed pursuant to this paragraph (i)(3).

(4) Specified employee effective date. Unless another date is designated in accordance with the requirements of this paragraph (i)(4) and paragraph (i)(8) of this section, the specified employee effective date is the first day of the fourth month following the specified employee identification date. A service recipient may designate in accordance with the requirements of paragraph (i)(8) of this section any date following the specified employee identification date as the specified employee effective date, provided that such date may not be later than the first day of the fourth month following the specified employee identification date, and provided further that a service recipient must use the same specified employee effective date with respect to all nonqualified deferred compensation plans, and any change to the specified employee effective date may not be effective for a period of at least 12 months. The service recipient may designate a specified employee effective date through inclusion in each plan document or through a separate document applicable to all plans, provided that the service recipient will not be treated as having designated a specified employee effective date on any date before the designation is legally binding on the service recipient and all affected service providers. Any designation of a specified employee effective date made on or before December 31, 2007, may be applied to any separation from service occurring on or after January 1, 2005, unless and until subsequently changed pursuant to this paragraph (i)(4).

(5) Alternative methods of satisfying the six-month delay rule. A plan may provide, in accordance with the requirements of paragraph (i)(8) of this section, for an alternative method to identify service providers who will be subject to the six-month delay rule provided in section 409A(a)(2)(B)(i), provided that the alternative method is reasonably designed to include all specified employees (determined without respect to any available service recipient elections), the alternative method is an objectively determinable standard providing no direct or indirect election to any service provider regarding its application, and the alternative method results in either all service providers or no more than 200 service providers being identified in the class as of any date. Use of such an alternative method will not be treated as a change in the time and form of payment for purposes of §1.409A-2(b) (the subsequent deferral rules), even if the service provider is not a specified employee when the payment is delayed.

(6) Corporate transactions—(i) Mergers and acquisitions of public service recipients. If as a result of a corporate transaction, two or more separate service recipients, more than one of which has stock outstanding that is publicly traded on an established securities market or otherwise immediately before the transaction, become one service recipient, any stock of which is publicly traded on an established securities market or otherwise immediately after the transaction (resulting public service recipient),
the resulting public service recipient’s next specified employee identification date and specified employee effective date following the corporate transaction are the specified employee identification date and specified employee effective date that the acquiring service recipient would have been required to use absent such transaction. For this purpose, in the case of a corporate merger, the acquiring service recipient is the service recipient that included the surviving corporation in such merger, in the case of an acquisition by a corporation of the stock of another corporation, the acquiring service recipient is the service recipient that included the corporation that acquired such stock, and in all other cases, the surviving service recipient is determined on the basis of all of the facts and circumstances. For the period between the transaction and the next specified employee effective date, the list of specified employees of the resulting public service recipient is determined by combining the lists of specified employees of all service recipients participating in the transaction that were in effect at the date of the corporate transaction, ranking such specified employees in order of the amount of compensation used to determine each specified employee’s status as a specified employee, and treating the top 50 of such specified employees, plus any employees described in section 416(i)(1)(ii) or section 416(i)(1)(iii) and the regulations thereunder (relating to 1-percent and 5-percent owners) who are not included in such top 50 specified employees, as specified employees for the period between the corporate transaction and the next specified employee effective date. Alternatively, the resulting service recipient may elect in accordance with the requirements of paragraph (i)(8) of this section to use any reasonable method to determine the specified employees of the resulting service recipient, including the use of an alternative method of compliance described in paragraph (i)(5) of this section, provided that such method is adopted no later than 90 days after the corporate transaction and applied prospectively from the date the method is adopted.

(ii) Mergers and acquisitions of nonpublic service recipients. If as part of a corporate transaction a service recipient that does not have outstanding stock that is publicly traded on an established securities market or otherwise immediately before the transaction (initial private service recipient), and a service recipient with stock outstanding that is publicly traded on an established securities market or otherwise immediately before the transaction (initial public service recipient), become a single service recipient having stock that is publicly traded on an established securities market or otherwise immediately after the transaction (resulting public service recipient), the resulting public service recipient’s next specified employee identification date and specified employee effective date following the corporate transaction are the specified employee identification date and specified employee effective date that the initial public service recipient would have been required to use absent such transaction. For the period after the date of the corporate transaction and before the next specified employee
effective date, the specified employees of the initial public service recipient immediately before the transaction continue to be the specified employees of the resulting public service recipient, and no service providers of the initial private service recipient are required to be treated as specified employees.

(iii) SpInoffs. If as part of a corporate transaction, a service recipient with stock outstanding that is publicly traded on an established securities market or otherwise immediately before the transaction (initial public service recipient), becomes two or more separate service recipients, each with stock outstanding that is publicly traded on an established securities market or otherwise immediately after the transaction (post-transaction public service recipients), the next specified employee identification date of each of the post-transaction public service recipients is the specified employee identification date that the initial public service recipient would have been required to use absent such transaction. For the period after the date of the corporate transaction and before the next specified employee effective date, the specified employees of the initial public service recipient immediately before the transaction continue to be the specified employees of the post-transaction public service recipients.

(iv) Public offerings and other corporate transactions. If as part of an initial public offering or corporate transaction not described in paragraph (i)(6)(ii) or (iii) of this section, a service recipient with no outstanding stock that is publicly traded on an established securities market or otherwise immediately before such offering or other transaction (initial private service recipient), becomes one or more service recipients with stock outstanding that is publicly traded on an established securities market or otherwise immediately after such offering or other transaction (post-transaction public service recipient), each posttransaction public service recipient has a specified employee identification date of December 31 and a specified employee effective date of April 1, effective retroactively to the December 31 and April 1 next preceding the offering or other transaction for purposes of identifying the specified employees between the corporation transaction and the next December 31. Alternatively, a posttransaction public service recipient may elect in accordance with the requirements of
paragraph (i)(8) of this section, a specified employee identification date and specified employee effective date on or before the date of the offering or other transaction. If a public service recipient makes such an election, for the period after the offering or other transaction and before the next specified employee effective date, the specified employees of the posttransaction public service recipient consist of the service providers that at the time of the offering or other transaction would have been classified as specified employees of the initial private service recipient, had the initial private service recipient elected the same specified employee identification date and specified employee effective date as selected by the post-transaction public service recipient, and had such initial private service recipient had stock publicly traded on an established securities market or otherwise as of the specified employee identification date preceding the transaction.

(v) Alternative methods of compliance. For purposes of this paragraph (i)(6), references to specified employees as of a corporate transaction or offering include any specified employees identified through the use of an alternative method described in paragraph (i)(5) of this section, where the use of such alternative method was established and effective at the time of the corporate transaction or offering.

(7) Nonresident alien employees. For purposes of determining key employees, a service recipient generally must include all employees, including employees who are nonresident aliens. However, a plan may provide without causing an amount to be treated as an additional deferral as to any affected participant that for purposes of applying the six-month delay to specified employees, all employees that are nonresident aliens during the entire 12-month period ending with the relevant identification date are excluded for purposes of determining which employees meet the requirements of section 416(i)(1)(A)(i), (ii), or (iii) (applied in accordance with the regulations thereunder and disregarding section 416(i)(5)), provided that a service recipient must apply such exclusion with respect to all arrangements of the service recipient, and any change to include such nonresident alien employees may not be, and therefore is a key employee, the incorporation of the rules of §1.415(c)-2(g)(5)(i), generally requiring the treatment as compensation of certain compensation excludible from an employee’s gross income due to the location of the services or the identity of the employer, applies. Accordingly, the rule of §1.415(c)-2(g)(5)(i), generally requiring the treatment as compensation of certain compensation excludible from an employee’s gross income due to the location of the services or the identity of the employer, applies. In addition, a service recipient may elect in accordance with paragraph (i)(8) of this section to apply the rule of §1.415(c)-2(g)(5)(ii) to not treat as compensation certain compensation excludible from an employee’s gross income on account of the location of the services or the identity of the employer that is not
effectively connected with the conduct of a trade or business within the United States. A service recipient may elect to apply the rule of §1.415-2(g)(5)(ii) regardless of whether the service recipient has elected to apply the rule to a qualified plan sponsored by the service recipient; however, once a list of specified employees has become effective, any election of the rule for a period of 12 months that period may not be changed. Notwithstanding the foregoing, any election of the rule made before January 1, 2008, may be effective with respect to any specified employee identification date on or before December 31, 2007.

(j) — Nonresident alien —

(8) Elections affecting the identification of specified employees. The elections described in paragraphs (i)(2) through (7) of this section are effective only as of the date that all necessary corporate action has been taken to make such elections binding for purposes of all affected nonqualified deferred compensation plans in which the service providers of the service recipient that would become a specified employee due to the application of such election participate. Where a taxpayer attempts to make an election under paragraph (i)(2), (3), (4), (5), (6), or (7) of this section but such election is not binding on all the affected nonqualified deferred compensation plans and applied consistently to all such service providers, the election is not effective and the rule under paragraph (i)(2), (3), (4), (5), (6), or (7) of this section, as applicable, that would apply absent an election is applicable for identifying specified employees.

(j) — Nonresident alien —

(1) Except as provided in paragraph (j)(2) of this section, for purposes of this section the term nonresident alien means an individual who is—

(i) A nonresident alien within the meaning of section 7701(b)(1)(B); or

(ii) A dual resident taxpayer within the meaning of § 301.7701(b)-7(a)(1) of this chapter with respect to any taxable year in which such individual is treated as a nonresident alien for purposes of computing the individual’s U.S. income tax liability.

(2) The term nonresident alien does not include—

(i) A nonresident alien with respect to whom an election is in effect for the taxable year under section 6013(g) to be treated as a resident of the United States;

(ii) A former citizen or long-term resident (within the meaning of section 877(e)(2)) who expatriated after June 3, 2004, and has not complied with the requirements of section 7701(n); or
(iii) An individual who is treated as a citizen or resident of the United States for the taxable year under section 877(g).

(k) Established securities market. For purposes of section 409A and the regulations thereunder, the term established securities market means an established securities market within the meaning of § 1.897-1(m).

(l) Stock right. For purposes of section 409A and these regulations, the term stock right means a stock option (other than an incentive stock option described in section 422 or an option granted pursuant to an employee stock purchase plan described in section 423) or a stock appreciation right.

(m) Separation pay arrangement. For purposes of section 409A and the regulations thereunder, the term separation pay arrangement means any arrangement that provides separation pay or, where an arrangement provides both amounts that are separation pay and that are not separation pay, that portion of the arrangement that provides separation pay. For purposes of this paragraph (m), the term separation pay means any amount of compensation where one of the conditions to the right to the payment is deferral of compensation (before the application of the exclusions from the definition of a deferral of compensation set forth in paragraph (b)(9) of this section) that will not be paid under any circumstances unless the service provider has had a separation from service, whether voluntary or involuntary, including payments in the form of reimbursements of expenses incurred, and the provision of other taxable benefits. Separation pay includes amounts payable due to a separation from service, regardless of whether in-kind benefits. A deferral of compensation that the service provider may receive without a separation from service does not become separation pay merely because the service provider elects to receive or receives the payment after or upon a separation from service. A deferral of compensation does not fail to be separation pay merely because the payment is conditioned upon the execution of a release of claims, noncompetition or nondisclosure provisions, or other similar requirements. Notwithstanding the foregoing, any amount, or entitlement to any amount, that acts as a substitute for, or replacement of, amounts deferred by the service recipient under a separate nonqualified deferred compensation plan constitutes a payment of compensation or deferral of compensation under the separate such nonqualified deferred compensation plan, and does not constitute separation pay.

(n) Involuntary separation from service—(1) In general. An involuntary separation from service means a separation from service due to the independent exercise of the unilateral authority of the service recipient to terminate the service provider’s services, other than due to the service provider’s implicit or explicit request, where the service provider was willing and able to continue performing services. An involuntary separation from service may include the service recipient’s failure to renew a contract at the time such contract expires, provided that the service provider was willing and able to execute a new contract providing terms and conditions substantially similar to those in the expiring contract and to continue providing such services. The determination of whether a separation from service is involuntary is based on all the facts and circumstances. Any characterization of the separation from service as voluntary or
involuntary by the service provider and the service recipient in the documentation of the separation from service is presumed to properly characterize the nature of the separation from service. However, the presumption may be rebutted where the facts and circumstances indicate otherwise. For example, if a separation from service is designated as a voluntary separation from service or resignation, but the facts and circumstances indicate that absent such voluntary separation from service the service recipient would have terminated the service provider’s services, and that the service provider had knowledge that the service provider would be so terminated, the separation from service is involuntary.

(2) Separations from service for good reason—

(i) In general. Notwithstanding paragraph (n)(1) of this section, a service provider’s voluntary separation from service will be treated for purposes of this section and §§1.409A-2 through 1.409A-6 as an involuntary separation from service if the separation from service occurs under certain limited bona fide conditions, where the avoidance of the requirements of section 409A is not a purpose of the inclusion of these conditions in the plan or of the actions by the service recipient in connection with the satisfaction of these conditions, and a voluntary separation from service under such conditions effectively constitutes an involuntary separation from service. Generally such conditions will be prespecified under an agreement to provide compensation upon a separation from service for good reason. Such a good reason (or a similar condition) must be defined to require actions taken by the service recipient resulting in a material negative change to the service provider in the service relationship, such as the duties to be performed, the conditions under which such duties are to be performed, or the compensation to be received for performing such services. Other factors taken into account in determining whether a separation from service for good reason effectively constitutes an involuntary separation from service include the extent to which the payments upon a separation from service for good reason are in the same amount and are to be made at the same time and in the same form as payments available upon an actual involuntary separation from service, and whether the service provider is required to give the service recipient notice of the existence of the condition that would result in treatment as a separation from service for good reason and a reasonable opportunity to remedy the condition.

(ii) Safe harbor. For purposes of this section and §§1.409A-2 through 1.409A-6, if a plan provides that a voluntary separation from service will be treated as an involuntary separation from service if the separation from service occurs under certain express conditions, a separation from service satisfying the conditions set forth in the plan will be treated as an involuntary separation from the service if the necessary conditions (or set of conditions) require the following:

(A) The separation from service must occur during a pre-determined limited period of time not to exceed two years following the initial existence of one or
more of the following conditions arising without the consent of the service provider:

(1) A material diminution in the service provider’s base compensation.

(2) A material diminution in the service provider’s authority, duties, or responsibilities.

(3) A material diminution in the authority, duties, or responsibilities of the supervisor to whom the service provider is required to report, including a requirement that a service provider report to a corporate officer or employee instead of reporting directly to the board of directors of a corporation (or similar governing body with respect to an entity other than a corporation).

(4) A material diminution in the budget over which the service provider retains authority.

(5) A material change in the geographic location at which the service provider must perform the services.

(6) Any other action or inaction that constitutes a material breach by the service recipient of the agreement under which the service provider provides services.

(B) The amount, time, and form of payment upon the separation from service must be substantially identical to the amount, time and form of payment payable due to an actual involuntary separation from service, to the extent such a right exists.

(C) The service provider must be required to provide notice to the service recipient of the existence of the condition described in paragraph (n)(2)(ii)(A) of this section within a period not to exceed 90 days of the initial existence of the condition, upon the notice of which the service recipient must be provided a period of at least 30 days during which it may remedy the condition and not be required to pay the amount.
(3) Special rule for certain collectively bargained plans. Notwithstanding the foregoing, for purposes of this paragraph (n), to the extent a plan is subject to a bona fide collective bargaining agreement covering services performed for multiple employers under which an employee must separate from service with all such employers in order to receive a payment, such plan may use any reasonable definition of involuntary separation from service, provided that such definition is consistent with any definition of a separation from service adopted under paragraph (h)(6) of this section, and provided further that the definition of an involuntary separation from service provided by the collective bargaining agreement was the subject of arm’s length negotiations between employee representatives and two or more employers, the agreement between employee representatives and such employers satisfies section 7701(a)(46), and the circumstances surrounding the agreement evidence good faith bargaining between adverse parties over such definition.

(o) Earnings. Whether a deferred amount constitutes earnings on an amount deferred, or actual or notional income attributable to an amount deferred, is determined under the principles defining income attributable to the amount taken into account under §31.3121(v)(2)-1(d)(2) of this chapter. Accordingly, with respect to an account balance plan, earnings on an amount deferred generally include an amount credited on behalf of a service provider under the terms of the plan that reflects a rate of return that does not exceed either the rate of return on a predetermined actual investment or, if the income does not reflect the rate of return on a predetermined actual investment, a reasonable rate of interest. With respect to nonaccount balance plans, earnings on an amount deferred generally include an increase, due solely to the passage of time, in the present value of the future payments to which the service provider has obtained a legally binding right, the present value of which constituted the amount deferred (determined as of the date such amount was deferred), but only if the amount deferred was determined using reasonable actuarial assumptions and methods. A right to earnings on an amount deferred generally is treated as a right to a deferral of compensation for purposes of this section and §§1.409A-2 through 1.409A-6. However, for purposes of any provision of this section and §§1.409A-2 through 1.409A-6 referring to earnings on deferred compensation (or similar terms), the use of an unreasonable rate of return, or unreasonable actuarial assumptions and methods, generally will result in the treatment of some or all of such a right to deferred compensation as a right only to deferred compensation, and not a right to earnings on deferred compensation, so that the provision will not be applicable. With respect to plans that are neither account balance plans nor nonaccount balance plans, these rules apply by analogy.

(p) In-kind benefits. The term in-kind benefits refers to services provided to or on behalf of a service provider, such as financial planning services, or tangible personal or real property made available for use by or on behalf of the service provider, such as the use of an aircraft or vehicle, and does not refer to a transfer of property within the meaning of section 83 and the regulations thereunder, or a promise to transfer, or an option to purchase or receive, property in the future.
§ 1.409A-2 Deferral elections

(a) Initial elections as to the time and form of payment—

(1) In general. An arrangement that is, or constitutes part of, a nonqualified deferred compensation plan meets the requirements of section 409A(a)(4)(B) only if the arrangement provides that under the terms of the plan, compensation for services performed during a service provider’s taxable year (the service year) may be deferred at the service provider’s election only if the election to defer such compensation is made and becomes irrevocable not later than the end of such period as may be latest date permitted in this paragraph (a). An election will not be considered to be revocable merely because the service provider or service recipient may make an election to change the time and form of payment pursuant to paragraph (b) of this section. Whether an arrangement or the service recipient may accelerate the time of payment pursuant to §1.409A-3(j)(4) (exceptions to prohibition on accelerated payments). Whether a plan provides a service provider an opportunity to elect the time or form of payment of compensation is determined based upon all the facts and circumstances surrounding the determination of the time and form of payment of the compensation. For purposes of this section, an election to defer includes an election as to the time of the payment, an election as to the form of the payment or an election as to both the time and the form of the payment, but does not include an election as to the medium of payment (for example, an election between a payment of cash or a payment of property). Except as otherwise expressly provided in these regulations this section, an election will not be considered made until such election becomes irrevocable under the terms of the relevant arrangement. Thus, applicable plan. Accordingly, a plan may provide that an election to defer may be changed at any time prior to before the last permissible date for making such an election. Where an arrangement provides the service provider a right to make an initial deferral election, and further provides that the election remains in effect until terminated or modified by the service provider, the election will be treated as made as of the date such election becomes irrevocable as to compensation for services performed during the relevant service year. For example, where an arrangement provides that a service provider’s election to defer a set percentage will remain in effect until changed or revoked, but that as of each December 31 the election becomes irrevocable with respect to salary payable in connection with respect to services performed in the immediately following year, the initial deferral election with respect to salary payable with respect to services performed in the immediately following year will be deemed to have been made as of the December 31 upon which the election became irrevocable. For purposes of this paragraph (a), the reference to a service period or a performance period refers to the period of service for which the right to the compensation arises, and may include periods before the grant of a legally binding right to the compensation. For example, where a service recipient grants a bonus based upon services performed in the calendar year 2010, but retains the discretion to rescind the bonus until 2011 such that the...
promise of the bonus is not a legally binding right, the period of service or performance period to which the compensation relates is the calendar year 2010.

(2) Service recipient elections. A plan that provides for a deferral of compensation for services performed during a service provider’s taxable year that does not provide the service provider with an opportunity to elect the time or form of payment of such compensation must designate the time and form of payment by no later than the later of the time the service provider first has a legally binding right to the compensation or, if later, the time the service provider would be required under this section to make such an election if the service provider were provided such an election. Such designation is treated as an initial deferral election for purposes of this section. Where a plan permits a service recipient to exercise discretion to disregard a service provider election as to the time or form of a payment, any service provider election that is subject to such discretion will be treated as revocable so long as such discretion may be exercised.

(3) General rule. An arrangement A plan that is, or constitutes part of, a nonqualified deferred compensation plan meets the requirements of section 409A(a)(4)(B) if under the terms of the plan provides that compensation for services performed during a service provider’s taxable year (the service year) may be deferred at the service provider’s election only if the election to defer such compensation is made not later than the close of the service provider’s taxable year next preceding the service year.

(4) Initial deferral election with respect to short-term deferrals. With respect to a service provider has a legally binding right to a payment of compensation in a subsequent taxable year that, absent a deferral election, would not be treated as a short-term deferral within the meaning of compensation pursuant to § 1.409A-1(b)(4), an election to defer such compensation may be made in accordance with the requirements of paragraph (b) of this section, applied as if the amount were a deferral of compensation and the scheduled payment date for the amount were the date the substantial risk of forfeiture lapses. Notwithstanding the requirements of paragraph (b) of this section, such a deferral election may provide that the deferred amounts will be payable upon a change in control event (as defined in § 1.409A-3(g)(5)) without regard to the five-year additional deferral requirement in paragraph (b) of this section.

(5) Initial deferral election with respect to certain forfeitable rights. With respect to a service provider has a legally binding right to a payment in a subsequent year that is subject to a forfeiture condition requiring the service provider’s continued continued to provide services for a period of at least 12 months from the date the service provider obtains the legally binding right to avoid forfeiture of the payment, an election to defer such compensation may be made on or before the 30th day after the service provider obtains the legally binding right to the compensation, provided that the election is made at least 12 months in advance of the earliest date at which the forfeiture condition could lapse. For purposes of this paragraph (a)(5), a condition will not be treated as failing to require the service provider to continue to provide services for a period of at least 12 months from the date the service provider obtains the legally binding right merely because the condition immediately lapses upon the death or disability (as defined in §1.409A-3(i)(4)) of the service provider, or upon a change in control event (as
defined in §1.409A3(i)(5)), provided that if death, disability, or a change in control event occurs and the condition lapses before the end of such 12-month period, a deferral election may be given effect only if the deferral election is permitted under this section without regard to this paragraph (a)(5).

(6) Initial deferral election with respect to a service recipient with a fiscal year other than the calendar year. In the case of a service recipient with a fiscal year other than the calendar year taxable year that is not the same as the taxable year of the service provider, a plan may provide that fiscal year compensation may be deferred at the service provider’s election only if the election to defer such compensation is made not later than the close of the service recipient’s fiscal taxable year next immediately preceding the first fiscal taxable year of the service recipient in which any services are performed for which such compensation is payable. For purposes of this paragraph (a)(6), the term fiscal year compensation means compensation relating to a period of service coextensive with one or more consecutive fiscal taxable years of the service recipient, of which no amount is paid or payable during the service recipient’s taxable year or years constituting the period of service. For example, fiscal year compensation generally would include a bonus to an individual employee with a calendar year taxable year that is based on a service period consisting of the service recipient’s two consecutive fiscal taxable years ending September 30, 2009, 2011, where the amount will be paid after the completion end of the service period second of such taxable years, but would not include either a bonus based on a calendar year service period consisting of one or more calendar years or salary that would otherwise be paid during such taxable years of the service recipient’s fiscal year.

(7) First year of eligibility—(i) In general. In the case of the first year in which a service provider becomes eligible to participate in a plan (as defined in §1.409A-1(e)), the service provider may make an initial deferral election within 30 days after the date the service provider becomes eligible to participate in such plan, with respect to compensation paid for services to be performed subsequent to after the election. In the case of a plan that does not provide for service provider elections with respect to the time or form of a payment, the time and form of the payment must be specified on or before the date that is 30 days after the date the service provider first becomes eligible to participate in such plan. For compensation that is earned based upon a specified performance period (for example, an annual bonus), where a deferral election is made in the first year of eligibility but after the beginning of the service period, the performance period, the election must apply only to the compensation paid for services performed after the election. For this purpose, an election will be deemed to apply to compensation paid for services performed subsequent to after the election if the election applies to the portion of the compensation no more than an amount equal to the total amount of the compensation for the performance period multiplied by the ratio of the number of days remaining in the performance period after the election over the total number of days in the performance period.

(ii) Eligibility to participate. For purposes of this paragraph (a)(7), a service provider is eligible to participate in a plan at any time during which, under the plan’s terms and
without further amendment or action by the service recipient, the service provider is eligible to accrue an amount of deferred compensation under the plan other than earnings on amounts previously deferred, even if the service provider has elected not to accrue (or has not elected to accrue) an amount of deferred compensation. Where a service provider has been paid all amounts deferred under a plan, and on and before the date of the last payment was not eligible to continue (or to elect to continue) to participate in the plan for periods after the last payment (other than through an election of a different time and form of payment with respect to the amounts paid), the service provider may be treated as initially eligible to participate in a plan as of the first date following such payment that the service provider becomes eligible to accrue an additional amount of deferred compensation. Where a service provider has ceased being eligible to participate in a plan (other than the accrual of earnings), regardless of whether all amounts deferred under the plan have been paid, and subsequently becomes eligible to participate in the plan again, the service provider may be treated as being initially eligible to participate in the plan if the service provider had not been eligible to participate in the plan (other than the accrual of earnings) at any time during the 24-month period ending on the date the service provider again becomes eligible to participate in the plan.

(iii) Application to excess benefit plans. For purposes of this paragraph (a)(7), a service provider is treated as initially eligible to participate in an excess benefit plan as of the first day of the service provider’s taxable year immediately following the first year the service provider accrues a benefit under the excess benefit plan; and any election made within 30 days following such date is treated as applying to benefits accrued under such plan for services performed before the election. For purposes of this paragraph (a)(7), the term excess benefit plan means all nonqualified deferred compensation plans in which a service provider participates, to the extent such plans do not provide for an election between current compensation (including a short-term deferral) and deferred compensation and solely provide deferred compensation equal to the excess of the benefits the service provider would have accrued under a qualified employer plan (as defined in §1.409A-1(a)(2)) in which the service provider also participates, in the absence of one or more of the
limits incorporated into the plan to reflect one or more of the limits on contributions or benefits applicable to the qualified employer plan under the Internal Revenue Code, over the benefits the service provider actually accrues under the qualified employer plan. For purposes of this paragraph (a)(7), once a service provider has accrued a benefit or deferred compensation under a plan in any year, the service provider will not become eligible for an initial deferral election based upon an accrual or deferral under an excess benefit plan in a subsequent year, even if the benefit or deferred compensation accrued in a previous year is forfeited or eliminated.

(8)  **PerformanceInitial deferral election with respect to performance-based compensation.—** In the case of any performance-based compensation based upon a performance period of at least 12 months (as defined in §1.409A-1(e)), an initial deferral election may be made with respect to such performance-based compensation on or before the date that is six months before the end of the performance period, provided that the service provider performed services continuously from a date no later than the beginning of the performance period or the date upon which the performance criteria are established through a date no earlier than the date upon which the service provider makes an initial deferral election. An initial deferral election may be made with respect to such performance-based compensation no later than the date that is six months before the end of the performance period the date an election is made under this paragraph (a)(8), and provided further that in no event may an election to defer performance-based compensation be made after such compensation has become both substantially certain to be paid and readily ascertainable. For purposes of this paragraph (a)(8), if the performance-based compensation is a specified or calculable amount, the compensation is readily ascertainable if and when the amount is first substantially certain to be paid. If the performance-based compensation is not a specified or calculable amount because, for example, the amount may vary based upon the level of performance, the compensation, or any portion of the compensation, is readily ascertainable when the amount is first both calculable and substantially certain to be paid. For this purpose, the performance-based compensation is bifurcated between the portion that is readily ascertainable and the amount that is not readily ascertainable. Accordingly, in general any minimum amount that is both calculable and substantially certain to be paid will be treated as readily ascertainable.

(9)  **Nonqualified deferred compensation arrangements plans linked to qualified employer plans—** With respect to an amount deferred under an arrangement that is, or constitutes part of, or certain other arrangements. If a nonqualified deferred compensation plan, where under the terms of the nonqualified deferred compensation arrangement provides that the amount deferred under the plan is the amount determined under the formula under which for determining benefits are determined under a qualified employer plan (as defined in § 1.409A-1(a)(2)) or a broad-based foreign retirement plan (as defined in §1.409A-1(a)(3)(v)) maintained by the service recipient but applied without regard to one or more limitations applicable to the qualified employer plan, the service provider is eligible for an initial deferral election based upon an accrual or deferral under an excess benefit plan in a subsequent year, even if the benefit or deferred compensation accrued in a previous year is forfeited or eliminated.
plans under the Internal Revenue Code or to the broad-based foreign retirement plan under other applicable law, or that the amount deferred under the nonqualified deferred compensation plan is determined as an amount offset by some or all of the benefits provided under the qualified employer plan, the operation of the qualified employer plan with respect to or the broad-based foreign retirement plan, an increase in amounts deferred under the nonqualified deferred compensation plan that results directly from changes in benefit limitations applicable to the qualified employer plan or the broad-based foreign retirement plan under the Internal Revenue Code or other applicable law does not constitute a deferral election even if such operation results in an increase of amounts deferred under the nonqualified deferred compensation plan, provided that such operation does not otherwise result in a change in the time or form of a payment under the nonqualified deferred compensation plan, and provided further that such change in the amounts deferred under the nonqualified deferred compensation plan does not exceed that change in the amounts deferred under the qualified employer plan or the broad-based foreign retirement plan, as applicable. In addition, with respect to such a nonqualified deferred compensation arrangement, the following actions or failures to act will not constitute a deferral election under the nonqualified deferred compensation arrangement, even if in accordance with the terms of the nonqualified deferred compensation arrangement, the actions or inactions result in an increase in the amounts deferred under the arrangement, provided that such actions or inactions do not otherwise affect the time or form of payment under the nonqualified deferred compensation plan and provided further that with respect to actions or inactions described in paragraphs (a)(9)(i) or (ii), the change in the amount deferred under the nonqualified deferred compensation plan does not exceed the change in the amounts deferred under the qualified employer plan or the broad-based foreign retirement plan, as applicable:

(i) A service provider’s action or inaction under the qualified employer plan or broad-based foreign retirement plan with respect to whether to elect to receive a subsidized benefit or an ancillary benefit under the qualified employer plan or broad-based foreign retirement plan.

(ii) The amendment of a qualified employer plan or broad-based foreign retirement plan to add or remove a subsidized benefit or an ancillary benefit, or to freeze or limit future accruals of benefits under the qualified plan or freeze or limit future accruals of benefits or reduce existing benefits under the broad-based foreign retirement plan.

(iii) A service provider’s action or inaction under a qualified plan subject to the qualified employer plan with respect to elective deferrals and other employee pre-tax contributions subject to the contribution restrictions under section 401(a)(30) or section 402(g), including an adjustment to a deferral election under the qualified employer plan subject to section 402(g), provided that for any given
calendar, taxable year, the service provider’s action or inaction does not result in an increase in the amounts deferred under all nonqualified deferred compensation arrangements in which the service provider participates (other than amounts described in paragraph (a)(9)(iv) of this section) in excess of the limit with respect to elective deferrals under section 402(g)(1)(A), (B), and (C) in effect for the taxable year in which such action or inaction occurs.

(iv) A service provider’s action or inaction under a qualified employer plan with respect to elective deferrals and other employee pre-tax contributions subject to the contribution restrictions under section 401(a)(30) or section 402(g), and after-tax contributions by the service provider to a qualified plan that provides for such contributions, that affects the amounts that are credited under one or more nonqualified deferred compensation arrangements as matching amounts or other similar amounts, contingent on service provider elective deferrals, employee pre-tax contributions, or after-tax contributions, provided that the total of such matching or contingent amounts, as applicable, are either forfeited or never credited under the nonqualified deferred compensation arrangement in the absence of such service provider’s elective deferral or after-tax contribution, and provided further that all of the service provider’s actions or inactions do not result in an increase during such taxable year in the amounts deferred under all nonqualified deferred compensation arrangements in which the service provider participates in excess of the limit with respect to elective deferrals under section 402(g) in effect for the taxable year in which such action or inaction occurs. See paragraph (b)(6) of this section, Example 12 and Example 13.

(10) Changes in elections under a cafeteria plan. A change in an election under a cafeteria plan does not constitute a deferral election with respect to an amount deferred under a nonqualified deferred compensation plan to the extent that the change in the amount deferred under the nonqualified deferred compensation plan results solely from the application of the change in amount eligible to be treated as compensation under the terms of the nonqualified deferred compensation plan resulting from the election change under the cafeteria plan, to a benefit formula under the nonqualified plan.
deferred compensation plan based upon the service provider’s eligible compensation, and only to the extent that such change applies in the same manner as any other increase or decrease in compensation would apply to such benefit formula.

(11) **Separation** Initial deferral election with respect to certain separation pay. In the case of separation pay (as defined in § 1.409A-1(b)(9)(i)) due to an actual involuntary separation from service, an initial deferral election may be made at any time up to the time the service provider obtains a legally binding right to the payment. This paragraph (a)(11) does not apply to any separation pay to which the service provider obtained a legally binding right before the negotiations at the time of the separation from service, including a right to a payment subject to a condition such as that the service provider separate from service other than for cause. In the case of separation pay due to participation in a window program (as defined in § 1.409A-1(b)(9)(vi)), the initial deferral election may be made at any time up to the time the election to participate in the window program becomes irrevocable.

(12) **Commissions** Initial deferral election with respect to certain commissions—(i) Sales commission compensation. For purposes of this paragraph (a), in the case of commission compensation, a service provider earning such sales commission compensation is treated as providing the services to which such compensation relates only in the service provider’s taxable year in which the customer remits payment to the service recipient or, if applied consistently to all similarly situated service providers, the service provider’s taxable year in which the sale occurs. For purposes of this paragraph (a)(12), the term sales commission compensation means compensation or portions of compensation earned by a service provider if a substantial portion of the services provided by such service provider to a service recipient consist of the direct sale of a product or service to an unrelated customer, the compensation paid by the service recipient to the service provider consists of either a portion of the purchase price for the product or service or an amount substantially all of which is calculated solely by reference to the volume of sales, and payment of the compensation is either contingent upon the service recipient receiving payment from an unrelated customer for the product or services or, if applied consistently to all similarly situated service providers, is contingent upon the closing of the sales transaction and such other requirements as may be specified by the service recipient before the closing of the sales transaction. For this purpose, a customer is treated as an unrelated customer only if the customer is not related to either the service provider or the service recipient. A person is treated as related to another person if the person would be treated as related to the other person under § 1.409A-1(f)(2) or the person would be treated as providing management services to the other person under § 1.409A-1(f)(3).

(11) **Initial deferral elections with respect to compensation paid for final payroll period**—

(ii) Investment commission compensation. For purposes of this paragraph (a), a service provider earning investment
commission compensation is treated as providing the services to which such compensation relates over the 12 months preceding the date as of which the overall value of the assets or asset accounts is determined for purposes of the calculation of the investment commission compensation. For purposes of this paragraph (a)(12), the term investment commission compensation means the compensation or the portion of compensation earned by a service provider if a substantial portion of the services provided by such service provider to a service recipient to which such compensation relates consists of sales of financial products or other direct customer services to an unrelated customer with respect to customer assets or customer asset accounts, the customer retains the right to terminate the customer relationship and may move or liquidate the assets or asset accounts without undue delay (which may be subject to a reasonable notice period), such compensation consists of a portion of the value of the overall assets or asset account balance, an amount substantially all of which is calculated by reference to the increase in the value of the overall assets or account balance during a specified period, or both, and the value of the overall assets or account balance and investment commission compensation is determined at least annually. For this purpose, a customer is treated as an unrelated customer only if the customer is not related to either the service provider or the service recipient. A person is treated as related to another person if the person would be treated as related to the other person under §1.409A-1(f)(2)(ii) or the person would be treated as providing management services to the other person under §1.409A-1(f)(2)(iv).

(iii) Commission compensation and related persons. The rules of paragraphs (a)(12)(i) and (ii) of this section apply to sales commission compensation and investment commission compensation involving a related customer, provided that substantial sales from which commission compensation arises are made, or substantial services from which commission compensation arises are provided, to unrelated customers by the service recipient, the sales and service arrangement and the commission arrangement with respect to the related customer are bona fide, arise from the service recipient’s ordinary course of business, and are substantially the same, both in terms and in practice, as the terms and practices applicable to unrelated customers (as defined in such paragraphs) to
which individually or in the aggregate substantial sales are made or substantial services provided by the service recipient.

(13) (i) Initial deferral election with respect to compensation paid for final payroll period—

In general. Unless an arrangement [plan] provides otherwise, compensation payable after the last day of the service provider’s taxable year solely for services performed during the final payroll period described in section 3401(b) containing the last day of the service provider’s taxable year or, with respect to a non-employee [nonemployee] service provider, a period not longer than the payroll period described in section 3401(b), where such amount is payable pursuant to the timing arrangement under which the service recipient normally compensates service providers for services performed during a payroll period described in section 3401(b), or with respect to a non-employee service provider, a period not longer than the payroll period described in section 3401(b), is treated as compensation for services performed in the subsequent taxable year in which the payment is made. The preceding sentence does not apply to any compensation paid during such period for services performed during any period other than such final payroll period, such as a payment of an annual bonus. Any amendment of an arrangement [plan] after December 31, 2006, 2007, to add a provision providing for a differing treatment of such compensation may not be effective for 12 months from the date the amendment is executed and enacted.

(ii) Transition rule. For purposes of this paragraph (a) (if), an arrangement [plan] that was adopted and effective before December 31, 2006, 2007, whether written or unwritten, will be treated as designating such compensation for services performed in the taxable year in which the payroll period ends, unless otherwise set forth in writing before December 31, 2006, 2007.

(12) Designation of time and form of payment with respect to a nonelective arrangement. An arrangement that provides for a deferral of compensation for services performed during a service provider’s taxable year that does not provide the service provider with an opportunity to elect the time of payment of such compensation must specify the time of payment no later than the time the service provider first has a legally binding right to the compensation. Similarly, an arrangement that provides for a deferral of compensation for services performed during a service provider’s taxable year that does not provide the service provider with an opportunity to elect the form of payment of such compensation must specify the form of payment no later than the time the service provider first has a legally binding right to the compensation. Such designation shall be treated as

(14) Elections to annualize recurring part-year compensation. In the case of a service provider receiving recurring part-year compensation, an election to defer all or a portion of the recurring part-year compensation to be earned during a particular service period is considered to meet the requirements of this paragraph (a) if the election is made before the services for which the recurring part-year compensation is paid begin.
and the election does not defer payment of any of the recurring part-year compensation to a date beyond the last day of the 13th month following the first date of the service period. For purposes of this paragraph (a)(14), the term recurring part-year compensation means compensation paid for services rendered in a position that the service recipient and service provider reasonably anticipate will continue on similar terms and conditions in subsequent years, and will require services to be provided during successive service periods each of which comprises less than 12 months (for example, a teacher providing services during a school year comprised of 10 consecutive months), and each of which periods begins in one taxable year of the service provider and ends in the next such taxable year. The rules of this paragraph (a)(14) apply to a particular amount of compensation only once, so that an amount deferred under this rule may not again be treated as recurring part-year compensation for purposes of this paragraph and subject to a second deferral election under this paragraph (a)(14).

(15) USERRA rights. The requirements of this paragraph (a) are deemed satisfied to the extent an initial deferral election for purposes of this section.

(13) Designation of time and form of payment with respect to earnings. An arrangement that provides for actual or notional earnings to be credited on amounts of deferred compensation may specify, in accordance with the requirements of this paragraph (a), that such earnings will be paid by a date not later than the 15th day of the third month following the calendar year for which the earnings are credited. To satisfy the requirements of this paragraph (a)(13), actual or notional earnings must be credited at least annually and the measure for such earnings must be either a specified, nondiscretionary interest rate (or a specified, nondiscretionary formula describing an interest rate such as, for example, the interest on a Treasury bond ± 2 percent) or a predetermined actual investment within the meaning of §31.3121(v)(2)-1(d)(2) of this chapter. For these purposes, a right to dividend equivalents with respect to a specified number of shares of service recipient stock (as defined in §1.409A-1(b)(5)(iii)) may be treated as a right to actual or notional earnings on an amount of deferred compensation.

(b) Subsequent changes in time and form of payment— is provided to satisfy the requirements of the Uniformed Service Employment and Reemployment Rights Act of 1994, as amended, 38 U.S.C. 4301-4334.

(1) In general— The Subsequent changes in time and form of payment— (1) In general. A plan that permits under a subsequent election a delay in a payment or a change in the form of payment (a subsequent deferral election), including a subsequent deferral election made by a service provider or a service recipient, satisfies the requirements of section 409A(a)(4)(C) are met if, in the case of a plan that only if the conditions of this paragraph (b) are met. For purposes of this paragraph (b), except as otherwise expressly provided in this section, a subsequent deferral election is not considered made until such election becomes irrevocable under the terms of the plan. Accordingly, a plan may provide that a subsequent deferral election may be changed at any time before the last permissible date for making such a subsequent deferral election. Where a plan permits a subsequent deferral election to delay a payment or to change the
form of payment of an amount of deferred compensation, the requirements of this paragraph are satisfied only if the following conditions are met:

(i) The plan requires that such election may not take effect until at least 12 months after the date on which the election is made.

(ii) In the case of an election related to a payment not described in § 1.409A-3(a)(2) (payment on account of disability), § 1.409A-3(a)(3) (payment on account of death), or § 1.409A-3(a)(6) (payment on account of the occurrence of an unforeseeable emergency), the plan requires that the payment with respect to which such election is made be deferred for a period of not less than five years from the date such payment would otherwise have been paid (or in the case of a life annuity or installment payments treated as a single payment, five years from the date the first amount was scheduled to be paid).

(iii) The plan requires that any election related to a payment described in § 1.409A-3(a)(4) (payment at a specified time or pursuant to a fixed schedule) may not be made not less than 12 months prior to the date the payment is scheduled to be paid (or in the case of a life annuity or installment payments treated as a single payment, 12 months prior to the date the first amount was scheduled to be paid).

(2) Definition of payments for purposes of subsequent changes in the time or form of payment—

(2) (i) Definition of payments for purposes of subsequent changes in the time or form of payment—(i) In general. Except as provided in paragraphs (b)(2)(ii) and (iii) of this section, the term payment refers to each separately identified amount to which a service provider is entitled to payment under a plan on a determinable date, and includes amounts applied for the benefit of the service provider. An amount is separately identified only if the amount may be objectively determined under a nondiscretionary formula. For example, an amount identified as 10 percent of the account balance as of a specified payment date would be a separately identified amount. A payment includes the provision of any taxable benefit, including payment in cash or in kind. In addition, a payment includes, but is not limited to, the transfer, cancellation, or reduction of an amount of deferred compensation in exchange for benefits under a welfare benefit plan, a fringe benefit excludible under section 119 or section 132, or any other benefit that is excluded from gross income. For additional rules relating to the application of this paragraph (b) to amounts payable at a fixed time or pursuant to a fixed schedule, see §1.409A-3(i)(1).
(ii) Life annuities—(A) In general. The entitlement to a life annuity is treated as the entitlement to a single payment. For purposes of this paragraph (b)(2)(ii), Accordingly, an election to delay payment of a life annuity, or to change the form of payment of a life annuity, must be made at least 12 months before the scheduled commencement of the life annuity, and must defer the payment for a period of not less than five years from the originally scheduled commencement of the life annuity. For purposes of §1.409A-1, this section, and §§1.409A-3 through 1.409A-6, the term life annuity means a series of substantially equal periodic payments, payable not less frequently than annually, for the life (or life expectancy) of the service provider or the joint lives (or life expectancies) of the service provider and, or a series of substantially equal periodic payments, payable not less frequently than annually, for the life (or life expectancy) of the service provider, followed upon the death or end of the life expectancy of the service provider by a series of substantially equal periodic payments, payable not less frequently than annually, for the life (or life expectancy) of the service provider’s designated beneficiary. A change in the form of a payment (if any). A change in designated beneficiary before any annuity payment has been made under the plan is not a change in the time or form of payment. A change in the form of a payment before any annuity payment has been made under the plan, from one type of life annuity to another type of life annuity before any with the same scheduled date for the first annuity payment has been made, is not considered a change in the time and form of a payment, provided that the annuities are actuarially equivalent applying reasonable actuarial assumptions, methods and assumptions. For purposes of this paragraph (b)(2)(ii), a requirement that a service provider obtain the consent of a spouse or other potential recipient of a survivor annuity to change a beneficiary or form of payment is disregarded, so that any annuity form that the service recipient could elect to receive with such consent is considered currently available.

(B) Certain features disregarded. Notwithstanding the foregoing provisions of this paragraph (b)(2)(ii), the following features are disregarded for purposes of determining whether a payment form is a life annuity within the meaning of this paragraph (b)(2)(ii), but are not disregarded for purposes of
determining whether a life annuity is the actuarial equivalent of another life annuity except as otherwise provided in this paragraph (b)(2)(ii):

(1) Term certain features under which annuity payments continue for the longer of the life of the annuitant or a fixed period of time.

(2) Pop-up features under which payments increase upon the death of the beneficiary or another event that eliminates the right to a survivor annuity.

(3) Cash refund features under which payment is provided upon the death of the last annuitant in an amount that is not greater than the excess of the present value of the annuity at the annuity starting date over the total of payments before the death of the last annuitant.

(4) Features under which an annuity form of payment provides higher periodic payments before the expected commencement of benefits under the Social Security Act (42 U.S.C. ch. 7) or the Railroad Retirement Act (45 U.S.C. 231 et. seq.) and lower periodic payments after such expected commencement date, so that the combined periodic payments under the arrangement and the Social Security Act or the Railroad Retirement Act, as applicable, are approximately level before and after such expected commencement date (Social Security or Railroad Retirement leveling features).

(5) Features providing for an increase in the annuity payment in a manner described in §1.401(a)(9)-6, Q&A-14(a)(1) or (2) (eligible cost-of-living adjustments).

(C) Subsidized joint and survivor annuities. For purposes of this paragraph (b)(2)(ii), a joint and survivor annuity will not fail to be treated as actuarially equivalent to a single life annuity due solely to the value of a subsidized survivor annuity.
benefit, provided that the annual lifetime annuity benefit available to the service provider under the joint and survivor annuity is not greater than the annual lifetime annuity benefit available to the service provider under the single life annuity alternative, and provided that the annual survivor annuity benefit is not greater than the annual lifetime annuity benefit available to the service provider under the joint and survivor annuity.

(D) Actuarial assumptions and methods. For purposes of this paragraph (b)(2)(ii), at any given time the same actuarial assumptions and methods must be used in valuing each annuity payment option, in determining whether the payments are actuarially equivalent and such assumptions must be reasonable. This requirement applies over the entire term of the service provider’s participation in the plan, such that the annuity payment must be actuarially equivalent at all times for the annuity payment options to be treated as one time and form of payment. There is no requirement that the same actuarial methods and assumptions be used over the term of a service provider’s participation in a plan. Accordingly, a plan may change the actuarial assumptions and methods used to determine the life annuity payments provided that all of the actuarial assumptions and methods are reasonable.

(iii) Installment payments. The entitlement to a series of installment payments that is not a life annuity is treated as the entitlement to a single payment, unless the arrangement plan provides at all times with respect to the amount deferred that the right to the series of installment payments is to be treated as a right to a series of separate payments. For purposes of §1.409A-1, this paragraph (b)(2)(iii), section, and §§1.409A-3 through 1.409A-6, a series of installment payments refers to an entitlement to the payment of a series of substantially equal periodic amounts to be paid over a predetermined period of years, except to the extent any increase (or decrease) in the amount reflects reasonable earnings (or losses) through the date the amount is paid. For this purpose, a series of installment payments over a predetermined period and a series of installment payments over a shorter or longer period, or a series of installment payments over the same predetermined period but with a different commencement
date, are different times and forms of payment. Accordingly, a change in the predetermined period or the commencement date is a change in the time and form of payment. Notwithstanding the foregoing, a schedule of payments does not fail to be an installment payment solely because such plan provides for an immediate payment of all remaining installments if the present value of the deferred amount to be paid in the remaining installment payments falls below a predetermined amount, and the immediate payment of such amount does not constitute an accelerated payment for purposes of §1.409A-3(i), provided that such feature including the predetermined amount is established by no later than the time and form of payment is otherwise required to be established, and provided further that any change in such feature including the predetermined amount is a change in the time and form of payment.

(iv) Transition rule. For purposes of this section, an arrangement that was adopted and effective before December 31, 2006, whether written or unwritten, that fails to make a designation as to whether the entitlement to a series of payments is to be treated as an entitlement to a series of separate payments under paragraph (b)(2)(iii) of this section is treated as having made such designation as of the later of the date on which the arrangement was adopted or became effective, on or before December 31, 2007, provided that such designation is set forth in writing on or before December 31, 2006.

(3) Beneficiaries. The rules of this paragraph (b) governing changes in the time and form of payment apply to elections by beneficiaries with respect to the time and form of payment, as well as elections by service providers or service recipients with respect to the time and form of payment to beneficiaries. An election to change the identity of a beneficiary does not constitute a change in the time and form of payment merely because the election changes the identity of the recipient of the payment, if the time and form of the payment is not otherwise changed. In addition, an election to change the identity of a beneficiary before the initial payment of a life annuity does not constitute a change in the time and form of payment if the change in the time of payments stems solely from the different life expectancy of the new beneficiary, such as in the case of a joint and survivor annuity.

(4) Domestic relations orders. The rules of this paragraph (b) governing changes in the time and form of payment do not apply to elections by individuals other than a service provider, with respect to payments to a person other than
the service provider, to the extent such elections are reflected in, or made in accordance with, the terms of a domestic relations order (as defined in section 414(p)(1)(B)).

(5) Coordination with prohibition against acceleration of payments. For purposes of applying the prohibition against the acceleration of payments contained in § 1.409A-3(ej), the definition of payment is the same as the definition provided in paragraph (b)(2) of this section. However, even though Accordingly, a change in the form of a payment that results in a more rapid schedule for payments generally may will not constitute an acceleration of a payment, if the change in the form of payment must comply is made in compliance with the subsequent deferral rules. For example, although a change in form from a 10-year installment payment treated as a single payment to a lump-sum payment would not constitute an acceleration, if the change in the form of the payment must comply is made in compliance with the requirements of paragraph (b)(1) of this section, generally meaning that the election to change to a lump-sum payment could not must be effective for made at least 12 months before the installment payments were scheduled to commence and the lump-sum payment could not be made until at least five years after the date the installment payments were scheduled to commence. See §1.409A-3(f)(4)(i) with respect to situations in which the failure to accelerate a payment or the modification of a plan term relating to certain accelerated payments will not be subject to the rules of this paragraph (b).

(6) Application to multiple payment events. In the case of a plan that permits a payment upon each of a number of potential permissible payment events, such as the earlier of a fixed date or separation from service, the requirements of paragraph (b)(1) of this section are applied separately to each payment (as defined in paragraph (b)(2) of this section) due upon each payment event. Notwithstanding the foregoing, the addition or deletion of a permissible payment event to a plan under which amounts were previously deferred is subject to the rules of this paragraph (b) where the addition or deletion of the permissible payment event may result in a change in the time or form of payment of the amount deferred. For application of the rules governing accelerations of payments to the addition of a permissible payment event to amounts deferred, see § 1.409A-33(j).

(7) Delay of payments under certain circumstances. A plan may provide, or be amended to provide, that a payment may be delayed to a date after the designated payment date under any of the following circumstances described in this paragraph (b),(7), and the provision will not fail to meet the requirements of establishing a permissible payment event and the delay in the payment will not constitute a subsequent deferral election, provided that once such a provision is applicable to an amount of deferred compensation, any failure to apply such a provision or modification of the plan to remove such a provision will constitute an acceleration of any payment to which such provision applied so long as the service recipient treats all payments to similarly situated service providers on a reasonably consistent basis.

(i) Payments subject to section 162(m). A plan may provide that a payment will be delayed where to the extent that the service recipient reasonably anticipates that if the
payment were made as scheduled, the service recipient’s deduction with respect to such payment otherwise would be limited or eliminated by would not be permitted due to the application of section 162(m), provided that the terms of the arrangement require the payment to be made either at the earliest date or during the service provider’s first taxable year in which the service recipient reasonably anticipates that, or should reasonably anticipate, that if the payment is made during such year, the deduction of the such payment of the amount will not be limited or eliminated barred by application of section 162(m) or the calendar year beginning with the date of the service provider’s separation from service and ending on the later of the last day of the taxable year of the service recipient in which the service provider separates from service, or the 15th day of the third month following the service provider’s separation from service, and provided further that where any scheduled payment to a specific service provider in a service recipient’s taxable year is delayed in accordance with this paragraph, the delay in payment will be treated as a subsequent deferral election unless all scheduled payments to that service provider that could be delayed in accordance with this paragraph are also delayed. Where the payment is delayed to a date on or after the service provider’s separation from service, the payment will be considered a payment upon a separation from service for purposes of the rules under §1.409A-3(i)(2) (payments to specified employees upon a separation from service) and, in the case of a specified employee, the date that is six months after a service provider’s separation from service is substituted for any reference to a service provider’s separation from service in the first sentence of this paragraph. No election may be provided to the service provider with respect to the timing of the payment under this paragraph (b)(7)(i).

(ii) Payments that would violate a loan covenant or similar contractual requirement. A plan may provide that a payment will be delayed where the service recipient reasonably anticipates that the making of the payment will violate a term of a loan agreement to which the service recipient is a party, or other similar contract to which the service recipient is a party, and such violation will cause material harm to the service recipient; provided that the terms of the arrangement require the payment to be made at the earliest date at which the service recipient
reasonably anticipates that the making of the payment will not cause such violation, or such violation will not cause material harm to the service recipient, and provided that the facts and circumstances indicate that the service recipient entered into such loan agreement (including such covenant) or other similar contract for legitimate business reasons, and not to avoid the restrictions on deferral elections and subsequent deferral elections under section 409A.

(ii) (iii) Payments that would violate Federal securities laws or other applicable law. A plan may provide that a payment may be delayed where the service recipient reasonably anticipates that the making of the payment will violate Federal securities laws or other applicable law; provided that the terms of the arrangement require the payment to be made at the earliest date at which the service recipient reasonably anticipates that the making of the payment will not cause such violation. For purposes of this paragraph (b)(5)(iii), the making of a payment that would cause inclusion in gross income or the application of any penalty provision or other provision of the Internal Revenue Code is not treated as a violation of applicable law.

(iii) (iv) Other events and conditions. A service recipient may delay a payment upon such other events and conditions as the Commissioner may prescribe in generally applicable guidance published in the Internal Revenue Bulletin. For additional rules applicable to certain delayed payments pursuant to a change in control event, see §1.409A-3(i)(5)(iv). For additional rules applicable to amounts payable because of an unforeseeable emergency, see §1.409A-3(i)(3).

(8) USERRA rights. The requirements of this paragraph (b) are deemed met to the extent an election to change the time or form of a payment of deferred compensation is provided to satisfy the requirements of the Uniformed Services Employment and Reemployment Rights Act of 1994, as amended, 38 U.S.C. 4301-4344.

(9) Examples. The following examples illustrate the application of the provisions of this section. For purposes of these examples, each employee is an individual with a calendar year taxable year, and is employed by the specified employer:

Example 1. Initial election to defer salary. Employee A is an individual employed by Employer X. Employer X sponsors an arrangement under which Employee A may elect to defer a percentage of Employee A’s salary. Employee A has
participated in the arrangement in prior years. To satisfy the requirements of this section with respect to salary earned in calendar year 2008, if Employee A elects to defer any amount of such salary, the deferral election (including an election as to the time and form of payment) must be made no later than December 31, 2007.

Example 2. Designation of time and form of payment where an initial deferral election is not provided. Employee A is an individual employed by Employer X. Employer XYX has a fiscal taxable year ending September 30. On July 1, 2007, in 2008, Employer XYX enters into a legally binding obligation to pay Employee AB a $10,000 bonus. The amount is not subject to a substantial risk of forfeiture and does not qualify as performance-based compensation as described in §1.409A-1(e). Employer XYX does not provide Employee AB an election as to the time and form of payment. Unless the amount is to be paid in accordance with the short-term deferral rule of § 1.409A-1(b)(4), to satisfy the requirements of this section, Employer XYX must specify the time and form of payment on or before July 1, 2007, to satisfy the requirements of this section.

Example 3. Initial election to defer bonus payable based on services during calendar year. Employee A is an individual employed by Employer X. Employer XXX has a fiscal taxable year ending September 30. Employee AC participates in a bonus plan under which Employee AC is entitled to a bonus for services performed during the calendar year that, absent an election by Employee AC, will be paid on March 15 of the following year. The amount is not subject to a substantial risk of forfeiture and does not qualify as performance-based compensation as described in §1.409A-1(e). If Employee AC elects to defer the payment of the bonus with respect to services rendered during calendar year 2008, to satisfy the requirements of this paragraph, Employee AC must elect the time and form of payment not later than December 31, 2007, to satisfy the requirements of this section.

Example 4. Initial election to defer bonus payable based on services during fiscal year other than calendar year. Employee A is an individual employed by Employer X. Employer XWW has a fiscal taxable year ending September 30. Employee AD participates in a bonus plan under which Employee AD is entitled to a bonus for services performed during Employer XWW’s fiscal year that, absent an election by Employee AD, will be paid on December 15 of the following fiscal year in which the fiscal year ends. The amount is not subject to a substantial risk of forfeiture and does not qualify as performance-based compensation as described in § 1.409A-1(e). The amount qualifies as fiscal year compensation. If Employee AD elects to defer the payment of the amount related to the fiscal year ending September 30, 2008, 2009, to satisfy the requirements of this section Employee AD must elect the time and form of payment not later than September 30, 2007, 2008.

Example 5. Initial election to defer bonus payable only if service provider completes at least 12 months of services after the election. Employee A is an individual employed by Employer X. Employer XVX has a calendar year fiscal taxable year. On March 1, 2006, 2008, Employer XVX grants Employee AE a $10,000 bonus, payable on March 1, 2008, 2010 (with reasonable interest), provided that Employee AE continues
performing services as an employee of Employer X through March 1, 2008. The amount does not qualify as performance-based compensation as described in § 1.409A-1(e), and Employee A already participates in another account balance nonqualified deferred compensation plan. Employee A may make an initial deferral election on or before March 31, 2006 (within 30 days after obtaining a legally binding right), because at least 12 months of additional services are required after the date of election for the risk of forfeiture to lapse.

Example 6. Initial election to defer bonus that would otherwise constitute a short-term deferral. The same facts as Example 5, except that Employee A does not make an initial deferral election on or before March 31, 2006. Because the right to the compensation would not be treated as a deferral of compensation pursuant to § 1.409A-1(b)(4) absent a deferral election (because the arrangement would be treated as a short-term deferral), Employee A may make an initial deferral election provided that the election may not become effective for 12 months and must defer the payment at least 5 years from March 1, 2008 (the first date the payment could become substantially vested). Accordingly, Employee A may make an election before March 1, 2007, provided that the election defers the payment to a date on or after March 1, 2013 (other than a payment due to death, disability, unforeseeable emergency, or a change in control event).

Example 7. Initial election to defer sales commissions. Employee A is an individual employed by Employer X. Employer X has a calendar year fiscal taxable year. As part of Employee A’s services for Employer X, Employee A sells refrigerators to customers unrelated to Employee F or Employer U. Under the employment arrangement, Employee A is entitled to 10% of the sales price of any refrigerator Employee A sells, payable only upon the receipt of payment from the customer who purchased the refrigerator. For purposes of the initial deferral rule, Employee A is treated as performing the services related to each refrigerator sale in the taxable calendar year in which each customer pays for the refrigerator.

Example 8. Initial election to defer renewal sales commissions. The same facts as Example 7, except that Employee A also sells warranties related to the refrigerators sold. Under the warranty arrangement, refrigerator warranty customers are entitled in a future year to extend the warranty for an additional cost to be paid at the time of the extension. Under Employee A’s arrangement with Employer X, Employee A is entitled to 10% of the amount paid for an extension of any warranty, payable upon the receipt of payment from the customer extending the warranty. For purposes of the initial deferral election rule, Employee A is treated as performing the services related to the amount paid for the extension of the warranty in the taxable year in which the customer pays for the warranty extension.

Example 9. Initial election to defer investment commissions. Employer TT is in the trade or business of managing financial assets for customer accounts. Customers who deposit funds in an account with Employer TT are entitled to remove the account balance of such account upon 60 days notice to Employer TT. Employee G sells financial products and provides continuing customer service to certain unrelated
customers involving the deposit and maintenance of funds in customer accounts managed by Employer TT. Under the employment arrangement, Employee G is entitled to a set percentage of the aggregate value of the assets held in the accounts of customers to whom Employee G sold financial products and provides customer service. Under the arrangement, the aggregate value of the assets held in the accounts is determined as of June 30 of each year, and unless Employee G elects to defer the payment, the amount is payable to Employee G in a lump sum on December 31 of the year in which the valuation is made. Employee G has no control over the valuation of the assets held in the accounts, or the calculation of the amount due Employee G. For purposes of the initial deferral rule, Employee G is treated as providing the services to which a payment relates during the July 1 through June 30 period ending on the June 30 date as of which the assets held in the account are valued.

Example 10. Initial election to defer part-year compensation. Employee H provides services as a teacher to Employer SS, a school system. The period of services routinely begins on the second Monday of August of one year and ends on the first Friday of June of the subsequent year. Employer SS provides an election to Employee H to receive the compensation for the period of services ratably over the period beginning on the second Monday of August of one year and ending on the last day of August of the subsequent year. Because the compensation constitutes recurring part-year compensation, as defined in paragraph (a)(14) of this section, and because the schedule will provide that all of the recurring part-year compensation is paid no later than September 30 of the subsequent year, Employee H will be deemed to have made a timely deferral election with respect to such recurring part-year compensation if Employee H elects before the first day of the service period to have the recurring part-year compensation paid under such schedule.

Example 11. Initial election to defer negotiated separation pay. Employee A is an individual employed by Employer X. Under the terms of a separation pay arrangement, Employee A is entitled upon an involuntary separation from service to an amount equal to two weeks of pay for every year of service at Employer X. Employer RR decides to terminate Employee J’s employment involuntarily. As part of the process of terminating Employee J, Employer RR enters into bona fide, arm’s length negotiations with respect to the terms of Employee J’s termination of employment. As part of the process, Employer RR offers Employee J an amount that is in addition to any amounts to which Employee J is otherwise entitled, payable either as a lump sum payment at the end of three years or in three annual payments starting at the date of termination of employment. The election of the time and form of payment by Employee J may be made at any time before Employee J accepts the offer and obtains a legally binding right to the additional amount. The election may not apply to any amount to which Employee J already had a legally binding right.

Example 10-12. Election of time and form of payments under a window program. Employee A is an individual employed by Employer X. Employer QQ establishes a window program, as defined in § 1.409A-1(b)(9)(vii). Individuals who elect to terminate employment under the window program are entitled to receive an amount equal to two weeks pay multiplied by every year of service with Employer
The individuals participating in the window program may elect to receive the payment as either a lump sum payment payable on the first day of the month after making the election to participate in the window program, or as a payment of two equal annual installments on each January 1 of the first two years following the election to participate in the window program. Employee AK is eligible to participate in the window program. Employee AK will be treated as making a timely deferral election if the election as to the time and form of payment is made on or before the date Employee AK’s election to participate in the window program becomes irrevocable.

Example 11. Initial election to defer salary earned during final payroll period beginning in one calendar year and ending in the subsequent calendar year. Employee A performs services as an employee of Employer X. Employer X pays the salary of its employees, including Employee AL, on a bi-weekly basis. One bi-weekly payroll period runs from December 24, 2006, through January 6, 2007, with a scheduled payment date of January 13, 2007. Employer X sponsors, and Employee AL participates in, a nonqualified deferred compensation arrangement under which Employee AL may defer a specified percentage of his annual salary. The arrangement does not specify that any salary compensation paid for the payroll period in which falls January 1 is to be treated as compensation for services performed during the year preceding the year in which falls that January 1. For purposes of applying the initial deferral election rules, Employee AL is deemed to have performed the services for the payroll period December 24, 2006, through January 6, 2007, during the calendar year 2007.

Example 12. Application of deferral election rules and anti-acceleration rules to a section 401(k) wrap plan. Employee A participates in a qualified retirement plan under section 401(a) with a qualified cash or deferred arrangement under section 401(k). Employee A also participates in a nonqualified deferred compensation arrangement. Under the terms of the nonqualified deferred compensation arrangement, Employee A elects, on or before December 31, to defer a specified percentage of his salary for the subsequent calendar year. Under the terms of the nonqualified deferred compensation arrangement and the qualified plan, as of the earliest date administratively practicable following the end of the year in which the salary is earned, the maximum amount that may be deferred under the qualified cash or deferred arrangement (not in excess of the amount specified under section 402(g) for the plan year) is credited to Employee A’s account under the qualified plan, and Employee A’s deferral under the nonqualified deferred compensation arrangement is reduced by a corresponding amount. The reduction has no effect on any other nonqualified deferred compensation arrangement in which Employee A participates. The reduction of Employee A’s account under the nonqualified deferred compensation arrangement is not treated as an accelerated payment of deferred compensation for purposes of section 409A.

Example 13. Application of deferral election rules and anti-acceleration rules to a nonqualified deferred compensation arrangement linked to a qualified defined benefit plan. Employee M participates in a qualified retirement plan that is a defined benefit plan. Employee M offers a subsidized early retirement benefit to employees who have attained age 55 and completed 30 years of service. Employee M, who has attained age 55 and completed 30 years of service, also
participates in a nonqualified deferred compensation arrangement, under which the benefit payable is calculated under a formula, with that benefit then reduced by any benefit which Employee AM has accrued under the qualified retirement plan. In 2007-2008, Employee AM fails to elect the subsidized early retirement benefit under the qualified retirement plan, with the effect that the amounts payable under the nonqualified deferred compensation arrangement are increased by an amount equal to the lesser reduction in the benefit payable under the qualified plan. Also, in 2007, Employer XNN amends the qualified retirement plan to increase benefits under the plan, resulting in a decrease in the amounts payable under the nonqualified deferred compensation arrangement equal to the greater increase in the benefit payable under the qualified plan. Neither of these actions constitutes a deferral election or an acceleration of a payment under the nonqualified deferred compensation arrangement.

Example 14. Subsequent deferral election. Employee AN participates in a nonqualified deferred compensation arrangement. Employee AN elects to be paid in a lump sum payment at the earlier of age 65 or separation from service. Employee AN anticipates that he will work after age 65, and wishes to defer payment to a later date. Provided that Employee AN continues in employment and makes the election by his 64th birthday, Employee AN may elect to receive a lump sum payment at the earlier of age 70 or separation from service.

Example 15. Grant of right to current payment of dividends paid with respect to restricted stock. Employer X grants Employee A stock that is not substantially vested for purposes of section 83, and Employee A does not make an election under section 83(b). As part of the restricted stock grant, Employee A receives the right to payments in an amount equal to the dividends payable with respect to the restricted stock. At the time Employer B grants Employee A the right to the dividend payments, the grant also specifies that each dividend payment will be made no later than the end of the calendar year in which the dividends are paid to shareholders of that class of stock or, if later, the 15th day of the third month following the date the dividends are paid to shareholders of that class of stock. The grant of the rights to dividend payments satisfies the requirement that deferred amounts be paid at a specified time or pursuant to a specified schedule.

Example 16. Subsequent deferral election rule – change in form of payment from lump sum payment to life annuity. Employee AP participates in a nonqualified deferred compensation arrangement. Employee AP elects to be paid in a lump sum payment at age 65. Employee AP wishes to change the payment form to a life annuity. Provided that Employee AP makes the election on or before his 64th birthday, Employee AP may elect to receive a life annuity commencing at age 70.

Example 17. Subsequent deferral election rule – change in form of payment from life annuity to lump sum payment. Employee AQ participates in a nonqualified deferred compensation arrangement. Employee AQ elects to be paid in a life annuity at age 65. Employee AQ wishes to change the payment form to a lump sum payment. Provided that Employee AQ makes the election on or before his 64th birthday, Employee AQ may elect to receive a lump sum payment at age 70.
Example 18.  Subsequent deferral election rule – installment payments designated as separate payments.  Employee AR, whose taxable year is the calendar year, participates in a nonqualified deferred compensation arrangement plan that provides for payment in a series of 5 equal annual amounts, each designated as a separate payment.  The first payment is scheduled to be made on January 1, 2008-2010.  Provided that Employee AR makes the election on or before January 1, 2007-2009, Employee AR may elect for the first payment scheduled to be made on January 1, 2013-2015, to be made on January 1, 2015.  If Employee AR makes that election, but does not elect to defer the remaining payments may, the remaining payments continue to be due upon January 1 of the four consecutive calendar years commencing on January 1, 2009-2011.

Example 19.  Subsequent deferral election rule – change in form of payment from installment payments not designated as separate payments to lump sum payment.  Employee AS participates in a nonqualified deferred compensation arrangement plan that provides for payment in a series of 5 equal annual amounts that are not designated as a series of 5 separate payments.  The first amount is scheduled to be paid on January 1, 2008-2010.  Employee AS wishes to receive the entire amount equal to the sum of all five of the amounts to be paid as a lump sum payment.  Provided that Employee AS makes the election on or before January 1, 2007-2009, Employee AS may elect to receive a lump sum payment on or after January 1, 2013-2015.

Example 20.  Subsequent deferral election rule – change in time form of payment from installment payments designated as separate payments to lump sum payment at specified age to payment at later of specified age or separation from service.  Employee AT participates in a nonqualified deferred compensation arrangement plan that provides for payment in a series of 5 equal annual amounts each of which is designated as a separate payment.  The first amount is scheduled to be paid on January 1, 2010.  Employee T wishes to receive the entire amount equal to the sum of all 5 of the amounts in a single lump sum payment.  Provided that Employee T makes the election on or before January 1, 2009, Employee T may elect to receive a lump sum payment on or after January 1, 2019.

Example 21.  Subsequent deferral election rule – change in form of payment from one life annuity form to another life annuity form.  Employee U participates in a nonqualified deferred compensation plan that permits Employee U to elect before Employee U’s separation from service whether to be paid in the form of a single life annuity beginning on the first day of the month following Employee U’s separation from service, or an annuity beginning on the first day of the month following Employee U’s separation from service under which annuity payments continue for Employee U’s lifetime but not less than 10 years.  The two types of annuities are actuarially equivalent at all times applying reasonable actuarial methods and assumptions.  For purposes of this section, the two types of annuities are treated as a single form of payment.  Accordingly, the election provided under the plan is not treated as providing a subsequent deferral election or accelerated payment, and an election by Employee U under the plan between the two annuity options made before the first scheduled payment date for an annuity payment is not treated as a subsequent deferral election or an acceleration of a payment.
Example 22. Subsequent deferral election rule – change in time of payment from payment at specified age to payment at later of specified age or separation from service. Employee V participates in a nonqualified deferred compensation plan that provides for a lump sum payment at age 65. Employee A wishes to add a payment provision such that the payment is deferred amount will be payable upon the later of a predetermined Employee V’s attainment of a specified age or separation from service. Provided that Employee A makes such election on or before his 64th birthday, Employee A may elect to modify the plan so Employee V will receive a lump sum payment upon the later of age 70 or separation from service.

Example 23. Subsequent deferral election rule – change in time of payment from payment at separation from service to payment at later of separation from service or specified age. Employee W participates in a nonqualified deferred compensation plan that provides for a lump sum payment at separation from service. Employee W wishes to make the payment payable upon the later of separation from service or a predetermined age. Provided that Employee W makes such election on or before the date 1 year before a separation from service, Employee W may elect to receive a lump sum payment upon the later of the date 5 years following a separation from service or at a specified age.

Example 24. Subsequent deferral election rule – change in time of payment from payment at separation from service to payment at a change in control event. Employee X participates in a nonqualified deferred compensation plan that provides for a lump sum payment at separation from service. Employee X wishes to change the payment provision such that the payment is payable upon a change in control event. A change in the distribution provision to provide for a payment only upon a change in control event will violate the rules governing payment provisions, because the change could result in an acceleration if the change in control event occurs before Employee X separates from service, or a subsequent deferral if the change in control does not occur until after Employee X separates from service. However, provided that Employee X makes such election on or before the date 1 year before a separation from service, Employee X may elect to receive a payment upon the later of a change in control event or 5 years following a separation from service.

(c) Special rules for certain resident aliens. For the first calendar taxable year of an individual in which such individual is classified as a resident alien, a nonqualified deferred compensation arrangement is deemed to meet the requirements of paragraph (a) of this section if, with respect to compensation payable for services performed during that first calendar taxable year or with respect to compensation the right to which is subject to a substantial risk of forfeiture as of January 1 of that first calendar taxable year, an initial deferral election is made by the end of such first calendar taxable year, provided that the initial deferral election may not apply to amounts paid or first payable on or before the date of such initial deferral that have already been paid or made available to the service provider before the election is made. For any year subsequent to after the first calendar taxable year in which an individual is classified as a resident alien, this paragraph (c) does not apply, provided that a calendar taxable year may again be treated as the first calendar taxable year in which an individual is classified as a
resident alien if such individual is classified as a resident alien in that taxable year and has not been classified as a resident alien for at least five consecutive calendar taxable years immediately preceding the year in which the individual is again classified as a resident alien that taxable year.

§ 1.409A-3 Permissible payments.

(a) In general. The requirements of this section are met only if the arrangement provides that an amount of deferred compensation may be paid only on account of one or more of the following:

(1) The service provider’s separation from service (as defined in § 1.409A-1(h) and in accordance with paragraph (i)(2) of this section).

(2) The service provider becoming disabled (in accordance with paragraph (g)(4) of this section).

(3) The service provider’s death.

(4) A time (or pursuant to a fixed schedule) specified under the plan (in accordance with paragraph (g)(1) of this section).

(5) A change in the ownership or effective control of the corporation, or in the ownership of a substantial portion of the assets of the corporation (in accordance with paragraph (g)(5) of this section).

(6) The occurrence of an unforeseeable emergency (in accordance with paragraph (g)(3) of this section).

(b) Designation of payment upon a permissible payment event. Except as otherwise specified in this section, a plan provides for the payment upon an event described in paragraph (a)(1), (2), (3), (5), or (6) of this section if the plan provides for the date of the event to be the payment date, or specifies another payment date that is objectively determinable and nondiscretionary at the time the event occurs (for example, 3 months following the date of initial disability or December 31 of the calendar year in which the disability first occurs). In addition, a plan may provide that a payment upon an event described in paragraph (a)(1), (2), (3), (5), or (6) of this section is to be made in accordance with a schedule that is objectively determinable and nondiscretionary based on the date the event occurs and that would qualify as a fixed schedule under paragraph (i)(1) of this section if the payment event were instead a fixed date, provided that the schedule must be fixed at the time the permissible payment event is designated. In addition, a plan may provide that a payment, including a payment that is part of a schedule, is to be made during a designated taxable year of the service provider that is objectively determinable calendar year following the year in which the payment event occurs (such as, for example, the calendar year following the year in which the service provider dies), provided that where no specific date within such
calendar year is objectively determinable, the payment date is deemed to be January 1 of such calendar year for purposes of applying a schedule of three substantially equal payments payable during the first three taxable years following the taxable year in which a separation from service occurs. A plan may also provide that a payment, including a payment that is part of a schedule, is to be made during a designated period objectively determinable and nondiscretionary at the time the payment event occurs, but only if the designated period both begins and ends within one taxable year of the service provider or the designated period is not more than 90 days and the service provider does not have a right to designate the taxable year of the payment (other than an election that complies with the subsequent deferral election rules of §1.409A-2(b)). Where a plan provides for a period of more than one day following a payment event during which a payment may be made, such as within 90 days following the date of the event, the payment date for purposes of the subsequent deferral election rules of §1.409A-1(b)(4). An arrangement under §1.409A-2(b) is treated as the first possible date upon which a payment could be made under the terms of the plan. A plan may provide for payment upon the earliest or latest of more than one event or time, provided that each event or time is described in paragraphs (a)(1) through (6) of this section. An arrangement may also provide that a payment upon an event described in paragraph (a)(1), (2), (3), (5) or (6) of this section is to be made in accordance with a fixed schedule that is objectively determinable based on the date of the event, provided that the schedule must be fixed at the time the permissible payment event is designated, and any change in the fixed schedule will constitute a change in the time and form of payment. For example, an arrangement may provide that a service provider is entitled to three substantially equal payments payable on each of the first three anniversaries of the date of the service provider’s separation from service. In addition, an arrangement may provide that payments are to be made pursuant to a schedule of payments based upon objectively determinable calendar years following the year in which the event occurs, (for example, three substantially equal payments to be made during the three calendar years following the year in which the service provider dies), provided that where payment dates within such calendar years are not specified under the terms of the arrangement, the payment dates are deemed to be January 1 of such calendar years for purposes of applying the subsequent deferral election rules of §1.409A-2(b). For examples illustrating the provisions of this paragraph, see paragraph (i)(1)(vi) of this section.

(c) Designation of alternative specified dates or payment schedules based upon date of permissible event. In general, in the case of an arrangement that provides that a payment is to be made in accordance with paragraph (b) of this section, or in accordance with a fixed schedule that is objectively determinable based on the date of the event in accordance with paragraph (b) of this section, the objectively determined date or fixed schedule must apply consistently regardless of the date on which the specified event occurs. However, an arrangement. For example, a plan does not satisfy the requirements of this paragraph (c) if it provides for one payment date or schedule of payments if a specified event occurs on a Monday, but another payment date or schedule of payments if the event occurs on any other day of the week. However, a plan that provides for a payment upon an event
described in paragraph (a)(2), (3), (5), or (6) of this section may allow for an alternative payment schedule if the event occurs on or before one (but not more than one) specified date. For example, an arrangement provided that the addition or deletion of such a different time and form of payment applicable to an existing deferral is subject to §1.409A-2(b) (subsequent deferral elections) and paragraph (j) of this section (accelerated payments). For example, a plan may provide that a service provider will receive a lump sum payment of the service provider’s entire benefit under the arrangement plan on the first day of the month following a separation from control event that occurs before the service provider attains age 55, but will receive 5 substantially equal annual payments commencing on the first day of the month following a separation from service on or after age 55 change in control event that occurs on or after the service provider attains age 55. In the case of a plan that provides that a payment upon an event described in paragraph (a)(1) of this section (a payment upon a separation from service), a different time and form of payment may be designated with respect to a separation from service under each of the following conditions, provided that the addition or deletion of such a different time and form of payment applicable to an existing deferral is subject to §1.409A-2(b) and paragraph (j) of this section:

(1) A separation from service during a limited period of time not to exceed two years following a change in control event (as defined in paragraph (i)(5) of this section).

(2) A separation from service before or after a specified date (for example, the attainment of a specified age), or a separation from service before or after a combination of a specified date, such as attaining a specified age, and a specified period of service determined under a predetermined, nondiscretionary, objective formula or pursuant to the method for crediting service under a qualified plan sponsored by the service recipient.

(3) A separation from service not described in paragraphs (c)(1) or (c)(2) of this section.

(d) When a payment is treated as made upon the designated payment date. Except as otherwise specified in this section, a payment is treated as made upon the date specified under the arrangement plan (including a date specified under paragraph (a)(4) of this section) if the payment is made at such date or a later date within the same calendar taxable year of the service provider or, if later, by the 15th day of the third calendar month following the date specified under the arrangement plan and the service provider is not permitted, directly or indirectly, to designate the taxable year of the payment. In addition, a payment is treated as made upon the date specified under the plan (including a date specified under paragraph (a)(4) of this section) and is not treated as an accelerated payment if the payment is made no earlier than 30 days before the designated payment date and the service provider is not permitted, directly or indirectly to designate the taxable year of the payment. For purposes of this paragraph, if the date specified is only a designated taxable year of the service provider, or a period of time during such a taxable year, the date specified under the plan is treated as the first day of such taxable year or the first day of the period of time during such taxable year, as
The payment with respect to a stock right generally occurs upon the exercise of the stock right, so that where a stock right designates a fixed exercise date, the stock right will be deemed to have been paid at such date if the exercise and payment occur on such date or a later date within the same taxable year of the service provider or, if later, by the 15th day of the third calendar month following the exercise date specified under the plan. If calculation of the amount of the payment is not administratively practicable due to events beyond the control of the service provider (or service provider’s estate beneficiary), the payment will be treated as made upon the date specified under the arrangement plan if the payment is made during the first calendar taxable year of the service provider in which the calculation of the amount of the payment is administratively practicable. Similarly, if the funds of the service recipient are not sufficient to make the payment at the date specified under the plan without jeopardizing the solvency of the service recipient, the payment will be treated as made upon the date specified under the arrangement plan if the payment is made during the first calendar taxable year in which the funds of the service recipient are sufficient to make the payment without jeopardizing the solvency of the service recipient, unless the making of the payment would not have such effect.

(e) Designation of time and form of payment with respect to earnings. A nonqualified deferred compensation plan that provides for actual or notional earnings to be credited on amounts of deferred compensation may specify, in accordance with the requirements of §1.409A-2(a) (initial deferral elections), that such earnings are treated separately from the right to the other amounts deferred under the plan for purposes of designating the time and form of payments under such plan, provided that to satisfy the requirements of this paragraph (e), actual or notional earnings must be credited at least annually. For these purposes, a right to dividend equivalents may be treated analogously to a right to actual or notional earnings on an amount of deferred compensation. For purposes of this paragraph (e), the term dividend equivalents means the right to an amount equal to all or a specified portion of dividends declared and paid, if any, on a specified number of shares of stock.

(f) Substitutions. Except as otherwise provided under these regulations, the payment of an amount as a substitute for a payment of deferred compensation will be treated as a payment of the deferred compensation. A forfeiture or voluntary relinquishment of an amount of deferred compensation will not be treated as a payment of the compensation, but there is no forfeiture or voluntary relinquishment for this purpose if an amount is paid, or a legally binding right to a payment is created, that acts as a substitute for the forfeited or voluntarily relinquished amount. Whether a payment or a right to a payment acts as a substitute for a payment of deferred compensation is determined based on all the facts and circumstances. However, where the payment of an amount results in an actual or potential reduction of, or current or future offset to, an amount of deferred compensation, or if the service provider receives a loan the repayment
of which is secured by or may be accomplished through an offset of or a reduction in an amount deferred under a nonqualified deferred compensation plan, the payment or loan is a substitute for the deferred compensation. In addition, where a service provider’s right to deferred compensation is made subject to anticipation, alienation, sale, transfer, assignment, pledge, encumbrance, attachment, or garnishment by creditors of the service provider or the service provider’s beneficiary, the deferred compensation is treated as having been paid. For the treatment of certain offsets, see paragraph (j)(4)(xiii) of this section. Even where there is no explicit reduction or offset, the payment of an amount or creation of a new right to a payment proximate to the purported forfeiture or voluntary relinquishment of a right to deferred compensation is presumed to be a substitute for the deferred compensation. The presumption is rebuttable by a showing that the compensation paid would have been received regardless of the forfeiture or voluntary relinquishment of the right to deferred compensation. Factors indicating that a payment would have been received regardless of such forfeiture or voluntarily relinquishment include that the amount paid is materially less than the forfeited or relinquished amount, or consists of a type of payment customarily made in the ordinary course of business of the service recipient to service providers who do not forfeit or relinquish deferred compensation (for example, a payment of accrued but unused leave or a payment for a release of actual or potential claims). See §1.409A-1(b)(9)(i) with respect to certain separation pay plans.

(g) (e) Disputed payments and refusals to pay. If a service recipient fails to make a payment is not made, in whole or in part, as of the date specified under the arrangement because the service recipient refuses to make such payment a plan, either intentionally or unintentionally, other than with the express or implied consent of the service provider, the payment will be treated as made upon the date specified under the arrangement plan if the service provider accepts the portion (if any) of the payment that the service recipient is willing to make (unless such acceptance will result in a forfeiture relinquishment of the claim to all or part of the remaining amount), makes prompt and reasonable, good faith efforts to collect the payment, and the payment is made during the first calendar remaining portion of the payment, and any further payment (including payment of a lesser amount that satisfies the obligation to make the payment) is made no later than the end of the first taxable year of the service provider in which the service recipient and the service provider enter into a legally binding settlement of such dispute, the service recipient concedes that the amount is payable, or the service recipient is required to make such payment pursuant to a final and nonappealable judgment or other binding decision. For purposes of this paragraph (e), efforts to collect the payment will be presumed not to be prompt, reasonable, good faith efforts, unless the service provider provides notice to the service recipient within 90 days of the latest date upon which the payment could have been timely made in accordance with the terms of the plan and these regulations, and unless, if not paid, the service provider takes further enforcement measures within 180 days after such latest date. For purposes of this paragraph (g), a service recipient is not treated as having refused failed to make a payment where pursuant to the terms of the plan the service provider is required to request payment, or otherwise provide information or take any other action, and the service provider has failed to take such action. In addition, for purposes of this paragraph (eg), the service provider is deemed to have requested that a
payment not be made, rather than the service recipient having refused to make such payment, where the service recipient’s decision to refuse to make the payment is made by the service provider or a member of the service provider’s family (as defined in section 267(c)(4) applied as if the family of an individual includes the spouse of any member of the family), or any person or group of persons over whom the service provider or service provider’s family member has effective control, or any person any portion of whose compensation is controlled the service provider or service provider’s family member.

(h) Special rule for certain resident aliens. An agreement, method, program, or other arrangement that is, or constitutes part of, a nonqualified deferred compensation plan is deemed to meet the requirements of this section with respect to any amount payable in the first calendar taxable year of the service provider in which a service provider is classified as a resident alien, and with respect to any amount payable in a subsequent calendar taxable year if no later than the December 31 last day of the first calendar taxable year of the service provider in which the service provider is classified as a resident alien, the plan is amended as necessary so that the times and forms of payment of amounts payable in a subsequent year comply with the provisions of this section. For any year subsequent to after the first calendar taxable year in which an individual is classified as a resident alien, this paragraph (h) does not apply, provided that a calendar taxable year may again be treated as the first calendar taxable year in which an individual is classified as a resident alien if such individual has not been classified as a resident alien for at least five consecutive calendar taxable years immediately preceding the taxable year in which the service provider is again classified as a resident alien.

(g) Definitions and special rules—

(i) Specified time or fixed schedule—(i) In general. Amounts are payable at a specified time or pursuant to a fixed schedule if objectively determinable amounts are payable at a date or dates that are nondiscretionary and objectively determinable at the time the amount is deferred. An amount is objectively determinable for this purpose if the amount is specifically identified or if the amount may be determined at the time payment is due pursuant to an objective, nondiscretionary formula specified at the time the amount is deferred (for example, 50 percent of an account balance). Except as otherwise provided in paragraph (i)(1) of this section, an amount is not objectively determinable if the amount of the payment is based all or in part upon the occurrence of an event, including the consummation of a transaction by, or a payment of an amount to, a service recipient. If an amount is payable in a service provider’s taxable year (or pursuant to a fixed schedule of taxable years of the service provider) that is designated at the time the amount is deferred and that is objectively determinable, the amount is treated as payable at a specified time (or pursuant to a fixed schedule), provided that for purposes of the application of the subsequent deferral rules contained in §1.409A-2(b), the specified time or fixed schedule of payments is deemed to refer to the first day of the relevant taxable year or years. A specified time or fixed schedule also includes the designation of a calendar at the time the amount is deferred of a defined period or periods within the service provider’s taxable year or taxable years that are objectively determinable at the
time the amount is deferred, provided that no such defined period may begin within one taxable year and end within another taxable year, and provided further that for purposes of the application of the subsequent deferral rules contained in § 1.409A-2(b), the specified time or fixed schedule of payments is deemed to refer to January 1—the first day of the relevant calendar year or years. An arrangement period in which the payment will be made. A plan may provide that a payment upon the lapse of a substantial risk of forfeiture is to be made in accordance with a fixed schedule that is objectively determinable based on the date the substantial risk of forfeiture lapses (disregarding any acceleration of the lapsing of the substantial risk of forfeiture other than due to the occurrence of a condition applicable as of the date the legally binding right to the payment arose that itself would constitute a discretionary acceleration of the lapse of the substantial risk of forfeiture), provided that the schedule must be fixed at the time and the time and form of payment are designated, and any change in the fixed schedule will constitute a change in the time and form of payment. For example, an arrangement plan that provides for a bonus payment subject to the condition that the service provider complete three years of service, but provided and subject to the further condition that such requirement of continued services will lapse upon the occurrence of an initial public offering that, which condition if applied alone would subject the right to the payment to constitute a substantial risk of forfeiture, may provide that a service provider is entitled to substantially equal payments on each of the first three anniversaries of the date the substantial risk of forfeiture lapses (the earlier of three years of service or the date of an initial public offering).

(ii) Payment schedules with formula and fixed limitations—

(A) Individual limitations. A schedule of payments does not fail to be a fixed schedule of payments where the amount of a payment or payments that may be paid at a specified time or during a specified period is limited by an objective nondiscretionary formula or a specified amount that is not under the effective control of the service provider and is not subject to the exercise of discretion by the service recipient, where such limitation is established on or before the date the time and form of payment is otherwise required to be set under these regulations, and the plan specifies the time and form of any payment that will be made or completed after its original payment date due to the application of the limitation. A change in the limitation or a change in the time and form of any payment that exceeds the limitation is subject to the requirements of §1.409A2(b) (subsequent deferral elections) and paragraph (i) of this section (accelerated payments). For purposes of this paragraph, a plan provision that reduces a schedule of periodic payments on a dollar-for-dollar basis by the amount of Social Security payments received or receivable may be treated as a nondiscretionary, objective formula limitation, if such reduction does not otherwise affect the time of payment.
of the deferred compensation (other than a forfeiture due to the reduction), including changes based on the service provider’s eligibility or elections related to Social Security benefits. Similarly, a plan provision that reduces a schedule of periodic payments on a dollar-for-dollar basis by the amount of bona fide disability pay (within the meaning of §1.409A-1(a)(5)) received or receivable may be treated as a nondiscretionary, objective formula limitation, if the disability payments are made pursuant to a plan sponsored by the service recipient that covers a substantial number of service providers and was established before the service provider became disabled, and if such reduction does not otherwise affect the time of payment of the deferred compensation (other than a forfeiture due to the reduction). Whether an amendment to, or other change in the benefit payable under, such bona fide disability plan results in an acceleration of a payment for purposes of paragraph (j) of this section or a subsequent election to delay the time or change the form of payment for purposes of §1.409A-2(b) is determined based on all of the relevant facts and circumstances.

(B) Limitations on aggregate payments to all participants in substantially identical plans. A schedule of payments does not fail to be a fixed schedule of payments where the amount of the aggregate payments that will be made during a specified period of time to all participants in substantially identical plans is limited by an objective nondiscretionary formula or specified amount that is not under the effective control of the service provider and is not subject to the exercise of discretion by the service recipient, where the limit is established on or before the date the time and form of payment of the amount deferred is otherwise required to be set under these regulations, the method of allocating payments among the participants where there is an overall limitation on the aggregate amount that may be paid to a group of service providers during a specified period is an objective nondiscretionary allocation method that is not under the effective control of the service provider and is not subject to the exercise of discretion by the service recipient, the method is established on or before the date the time and form of payment of the amount deferred is otherwise required to be set, and the plan specifies the time
and form of any payment of any amount that will be paid after its original payment date due to the application of the limitation. A change in the limitation or a change in the time and form of payment of any payment that is not otherwise made at the scheduled payment date due to application of the formula limitation is subject the requirements of §1.409A-2(b) (subsequent deferral elections) and paragraph (j) of this section (accelerated payments).

(iii) Payment schedules determined by timing of payments received by the service recipient. A payment schedule determined by reference to the timing of payments received by the service recipient (not including payments from one entity to another entity where both entities are treated as part of a single service recipient), meets the requirements of a specified date or fixed schedule of payments if the following conditions are met:

(A) The payments due to the service recipient arise from bona fide and routine transactions in the ordinary course of business of the service recipient.

(B) The service provider does not have effective control of the service recipient, the person from whom such amounts are due, or the collection of any of the amounts due to the service recipient.

(C) The payment schedule provides an objective, nondiscretionary method of identification of the payments to the service recipient from which the amount of the payment from the service recipient to the service provider is determined.

(D) The payment schedule provides an objective, nondiscretionary schedule under which the payments will be made to the service provider.

(E) The payments to the service recipient from which the amount of the payments from service recipient to the service provider are determined result from sales of a type that the service recipient is in the trade or business of making and makes frequently, and either all such sales by the service recipient are taken into account for purposes of determining the payment to the service provider, or there is a
(iv) Reimbursement or in-kind benefit plans—(A) General rule. A plan that provides for reimbursements of expenses incurred by a service provider, or in-kind benefits, meets the requirements of a specified date or fixed schedule of payments with respect to such reimbursements or benefits if the following conditions are met:

1. The plan provides an objectively determinable nondiscretionary definition of the expenses eligible for reimbursement or of the in-kind benefits to be provided.

2. The plan provides for the reimbursement of expenses incurred or for the provision of the in-kind benefits during an objectively and specifically prescribed period (including the lifetime of the service provider).

3. The plan provides that the amount of expenses eligible for reimbursement, or in-kind benefits provided, during a service provider’s taxable year may not affect the expenses eligible for reimbursement, or in-kind benefits to be provided, in any other taxable year.

4. The reimbursement of an eligible expense is made on or before the last day of the service provider’s taxable year following the taxable year in which the expense was incurred.

5. The right to reimbursement or in-kind benefits is not subject to liquidation or exchange for another benefit.

(B) Medical reimbursement arrangements. Notwithstanding the foregoing, an arrangement providing for the reimbursement of expenses referred to in section 105(b) will not be deemed to fail to meet the requirements of paragraph (i)(1)(iv)(A)(3) of this section solely because the arrangement provides for a limit on the amount of expenses that may be reimbursed under such
arrangement over some or all of the period in which the reimbursement arrangement remains in effect.

(v) Tax gross-up payments. A plan providing a right to a tax gross-up payment will be treated as providing for payment at a specified time or on a fixed schedule of payments if the plan provides that payment will be made, and the payment is made, by the end of the service provider’s taxable year next following the service provider’s taxable year in which the service provider remits the related taxes. For purposes of this paragraph (i)(1)(v), the term tax gross-up payment refers to a payment to reimburse the service provider in an amount equal to all or a designated portion of the Federal, state, local, or foreign taxes imposed upon the service provider as a result of compensation paid or made available to the service provider by the service recipient, including the amount of additional taxes imposed upon the service provider due to the service recipient’s payment of the initial taxes on such compensation. In addition, a right to the reimbursement of expenses incurred due to a tax audit or litigation addressing the existence or amount of a tax liability, whether Federal, state, local, or foreign, satisfies the requirement of a fixed time and form of payment if the right to the reimbursement provides that payment will be made, and the payment is made, by the end of the service provider’s taxable year following the service provider’s taxable year in which the taxes that are the subject of the audit or litigation are remitted to the taxing authority, or where as a result of such audit or litigation no taxes are remitted, the end of the service provider’s taxable year following the service provider’s taxable year in which the audit is completed or there is a final and nonappealable settlement or other resolution of the litigation. Nothing in this paragraph (i)(1)(v) otherwise alters the application of section 409A to the underlying compensation arrangement or other arrangement that results in the taxes subject to the right to the tax gross-up payment.

(vi) Examples. The following examples (in which each employee is an individual whose taxable year is the calendar year) illustrate the principles of paragraphs (a), (b), (c), (d), and (i)(1) of this section:

Example 1. Employee A provides services as an employee of Employer Z, but is not a specified employee. Employee A participates in a nonqualified deferred
compensation plan providing for a lump sum payment payable on or before December 31 of the calendar year in which Employee A separates from service. The plan provides for a payment upon a separation from service in compliance with this section.

Example 2. Employee B provides services as an employee of Employer Y, but is not a specified employee. Employee B participates in a nonqualified deferred compensation plan providing for a lump sum payment payable on or before the 90th day immediately following the date upon which Employee B separates from service. Employer Y retains the sole discretion to determine when during the 90-day period the payment will be made. Although the plan does not specify a period during one calendar year in which the payment will be made, the plan provides for a payment upon a separation from service in compliance with this section because the period over which the payment may be made is not longer than 90 days.

Example 3. Employee C provides services as an employee of Employer X, but is not a specified employee. Employee C participates in a nonqualified deferred compensation plan providing for a lump sum payment payable on or before the 180th day following the date upon which Employee C separates from service. Employer X retains the sole discretion to determine when during the 180-day period the payment will be made. Because the plan does not specify a period during one calendar year in which the payment will be made, and because the period over which the payment may be made is longer than 90 days, the plan does not provide for a payment upon a separation from service that complies with this section.

Example 4. Employee D provides services as an employee of Employer W, but is not a specified employee. Employee D participates in a nonqualified deferred compensation plan providing for 10 installment payments payable on the first 10 anniversaries of the date Employee D separates from service, provided that no installment payment in any year may be more than 1% of Employer W’s net income for the previous calendar year, and provided further that the excess over such limit that would otherwise be payable but is not paid due to application of the limit will become payable as of the first installment payment date at which time such amount, in combination with any installment payment otherwise due Employee D, does not exceed 1% of Employer W’s net income for the previous calendar year. Provided that Employee D does not retain effective control of the calculation of Employer W’s net income or the amount that Employee D will not be paid due to application of the limit, the plan provides for a schedule of payments upon a separation from service that complies with this section.

Example 5. Employee E and Employee F provide services as employees of Employer V, but neither is a specified employee. Employee E and Employee F both participate in substantially identical nonqualified deferred compensation plans providing for 10 installment payments payable on the first 10 anniversaries of the date the respective employee separates from service, provided that the total amount of installment payments in any year may not be more than 1% of Employer V’s net income for the previous year, that where any payments are not made due to application of the limit the determination of the amount not paid to a particular employee will be made by applying the overall limit proportionately based upon the installment payment due the employee that year, and that
the excess over such limit that would otherwise be payable but is not paid due to
application of the limit will become payable as of the first installment payment date at
which time such amount, in combination with any installment payments otherwise due
to the participants, does not exceed 1% of Employer V’s net income for the previous
calendar year. Provided that neither Employee E nor Employee F retains effective
control of the calculation of Employer V’s net income or the amount that the respective
employee will not be paid due to application of the limit, the plan provides for a schedule
of payments upon a separation from service that complies with this section.

Example 6. Employee G provides services as an employee of Employer
U, but is not a specified employee. As a bona fide part of this employment relationship,
Employee G provides professional services to clients of Employer U as part of the bona
fide, ordinary course of Employer U’s trade or business. Under an arrangement between
Employee G and Employer U, Employer U agrees to pay Employee G upon Employee
G’s separation from service an amount equal to 5% of any amount collected from
Company T, a client of Employer U for which Employee G performed services during his
employment with Employer U, during the 36 months following Employee G’s separation
from service. Under the arrangement, the amounts due to Employee G based upon
payments received by Employer U during any calendar year are payable to Employee G
on April 1 of the subsequent calendar year. Provided that Employee G does not have
effective control of Employer U, Company T, or the collection of any amounts due
Employer Y from Company T, the arrangement provides for a schedule of payments
upon a separation from service that complies with this section.

Example 7. Employee H provides services as an employee of Employer S,
but is not a specified employee. Under a plan sponsored by Employer S, Employee H has
a legally binding right upon a separation from service to the reimbursement of country
club dues paid in the calendar year of the separation from service and each of the next 3
calendar years following the separation from service in an amount not to exceed $30,000
in any calendar year, provided that the amount of dues paid in any calendar year that are
eligible for reimbursement equals only the amount actually expended during such
calendar year, and the maximum amount available for reimbursement in any calendar
year will not be increased or decreased to reflect the amount expended or reimbursed in a
prior or subsequent calendar year. The plan further provides that any reimbursement
must be paid to Employee H by December 31 of the calendar year following the year in
which Employee H pays the country club dues. The reimbursement plan provides for a
schedule of payments upon a separation from service that complies with this section.

Example 8. Employee J provides services as an employee of Employer Q,
but is not a specified employee. Under a plan sponsored by Employer Q, Employee J has
a legally binding right upon a separation from service to the reimbursement of country
club dues paid during the calendar year in which the separation from service occurs and
the next 3 calendar years in a total amount not to exceed $90,000. The plan further
provides that any reimbursement must be paid to Employee J by December 31 of the
calendar year following the year in which Employee J pays the country club dues.
Because the reimbursement of a payment of country club dues in one calendar year may
affect the amount of country club dues available for reimbursement in another calendar
year, the plan does not provide for a schedule of payments upon a separation from service that complies with this section.

(2) **Required Separation from service—required** delay in payment to a specified employee pursuant to a separation from service—(i) **In general.** In the case of any service provider who is a specified employee (as defined in § 1.409A-1(i)) as of the date of a separation from service, the requirements of paragraph (a)(1) of this section permitting a payment upon a separation from service are satisfied only if payments may not be made before the date that is six months after the date of separation from service (or, if earlier, than the end of the six-month period, the date of death of the specified employee). The arrangement must provide the manner in which the six-month delay will be implemented in the case of a service provider who is a specified employee. For example, an arrangement may provide that payments to which a specified employee would otherwise be entitled during the first six months following the date of separation from service are accumulated and paid at another specified date or specified schedule, such as the first date of the seventh month following the date of separation from service. The arrangement may also provide that each installment payment to which a specified employee is entitled upon a separation from service is delayed by six months. A service recipient may amend a plan at any time to change the method for applying the six-month delay, provided that the amendment may not be effective for a period of 12 months. For this purpose, a service provider who is not a specified employee as of the date of a separation from service will not be treated as subject to this requirement even if the service provider would have become a specified employee if the service provider had continued to provide services through the next specified employee effective date. Similarly, a service provider who is treated as a specified employee as of the date of a separation from service will be subject to this requirement even if the service provider would not have been treated as a specified employee after the next specified employee effective date had the specified employee continued providing services through the next specified employee effective date. Notwithstanding the foregoing, an amendment to a plan may be effective immediately in the case of a service recipient that amends the arrangement prior to the date upon which the service recipient’s stock first becomes readily tradable on an established securities market. Notwithstanding the foregoing, this paragraph (i)(2) also does not apply to a payment made under the circumstances described in paragraph (h)(2)(i)(v) (domestic relations order), (h)(2)(i)(vii) (conflicts of interest), or (h)(2)(i)(viii) (payment of employment taxes) of this section.

(3) **Unforeseeable Emergency**—

(ii) **Application of payment rules to delayed payments.** The required delay in payment is met if payments to which a specified employee would otherwise be entitled during the first six months following the date of separation from service are accumulated and paid on the first day of the seventh month following the date of separation from service, or if each payment to which a specified employee is otherwise entitled upon a separation from service is
delayed by six months. A service recipient may retain discretion to choose which method will be implemented, provided that no direct or indirect election as to the method may be provided to the service provider. For an affected specified employee, a date upon which the plan or the service recipient designates that the payment will be made after the six-month delay is treated as a fixed payment date for purposes of paragraph (d) of this section once the separation from service has occurred.

(3) (i) Unforeseeable emergency.--(ii) Amount of payment permitted upon an unforeseeable emergency. Distributions because of an unforeseeable emergency must be limited to the amount reasonably necessary to satisfy the emergency need (which may include amounts necessary to pay any Federal, state,
local, or foreign income taxes or penalties reasonably anticipated to result from the distribution. Determinations of amounts reasonably necessary to satisfy the emergency need must take into account any additional compensation that is available if the plan provides for cancellation of a deferral election upon a payment due to an unforeseeable emergency. See paragraph (h)(2)(vii) of this section. However, the determination of amounts reasonably necessary to satisfy the emergency need is not required to take into account any additional compensation that due to the unforeseeable emergency is available under another nonqualified deferred compensation plan but has not actually been paid, or that is available due to the unforeseeable emergency under another plan that would provide for deferred compensation except due to the application of the effective date provisions under §1.409A-6. The payment may be made from any arrangement plan in which the service provider participates that provides for payment upon an unforeseeable emergency, provided that the arrangement plan under which the payment was made must be designated at the time of payment.

(4) Disability

(iii) Payments due to an unforeseeable emergency. A service provider may retain discretion with respect to whether to apply for a payment upon an unforeseeable emergency, and a service recipient may retain discretion with respect to whether to make a payment available under the plan due to an unforeseeable emergency. A service provider who has experienced an unforeseeable emergency will not be treated as making a subsequent deferral election under §1.409A-2(b) (subsequent deferral election rules) if the service provider does not apply for or elect to receive a payment available under the plan. A service recipient will not be treated as making a subsequent deferral election under §1.409A-2(b) (subsequent deferral election rules) if the service recipient exercises its discretion not to make a payment otherwise available due to an unforeseeable emergency.

(4) (i) Disability--(i) In general. For purposes of §§1.409A-1 and 1.409A-2, this section, and §§1.409A-4 through 1.409A-6, except as otherwise specifically provided, a service provider is considered disabled if the service provider meets one of the following requirements:
(A) The service provider is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment that can be expected to result in death or can be expected to last for a continuous period of not less than 12 months.

(B) The service provider is, by reason of any medically determinable physical or mental impairment that can be expected to result in death or can be expected to last for a continuous period of not less than 12 months, receiving income replacement benefits for a period of not less than three months under an accident and health plan covering employees of the service provider’s employer.

(ii) Limited plan definition of disability. An arrangement may provide for a payment upon any disability, and need not provide for a payment upon all disabilities, provided that any disability upon which a payment may be made under the arrangement complies with the provisions of this paragraph (g)(4).

(iii) Determination of disability. An arrangement may provide that a service provider will be deemed disabled if determined to be totally disabled by the Social Security Administration. An arrangement or Railroad Retirement Board may also provide that a service provider will be deemed disabled if determined to be disabled in accordance with a disability insurance program, provided that the definition of disability applied under such disability insurance program complies with the requirements of this paragraph (g)(4).

(5) Change in the ownership or effective control of a corporation, or a change in the ownership of a substantial portion of the assets of a corporation—

(5)(i) Change in the ownership or effective control of a corporation, or a change in the ownership of a substantial portion of the assets of a corporation—In general. Pursuant to section 409A(a)(2)(A)(v), an arrangement may permit a payment upon the occurrence of a change in the ownership of the corporation (as defined in paragraph (g)(5)(v) of this section), a change in effective control of the corporation (as defined in paragraph (g)(5)(vi) of this section), or a change in the ownership of a substantial portion of the assets of the corporation (as defined in paragraph (g)(5)(vii) of this section) (collectively referred to as a change in control event). To qualify as a change in control event, the occurrence of the event must be objectively determinable and any requirement that any other person or group, such as a plan administrator or
board of directors compensation committee, certify the occurrence of a change in control event must be strictly ministerial and not involve any discretionary authority. The arrangement plan may provide for a payment on any particular type or types of change in control events, and need not provide for a payment on all such events, provided that each event upon which a payment is provided qualifies as a change in control event. For rules regarding the ability of the service recipient to terminate the arrangement plan and pay amounts of deferred compensation upon a change in control event, see paragraph (hj)(24)(ix)(B) of this section.

(ii) Identification of relevant corporation

(A) In general. To constitute a change in control event as with respect to the service provider, the change in control event must relate to—

(1) The corporation for whom the service provider is performing services at the time of the change in control event;

(2) The corporation that is liable for the payment of the deferred compensation (or all corporations liable for the payment if more than one corporation is liable) but only if either the deferred compensation is attributable to the performance of service by the service provider for such corporation (or corporations) or there is a bona fide business purpose for such corporation or corporations to be liable for such payment and, in either case, no significant purpose of making such corporation or corporations liable for such payment is the avoidance of Federal income tax; or

(3) A corporation that is a majority shareholder of a corporation identified in paragraph (e)(5)(ii)(A)(1) or (2) of this section, or any corporation in a chain of corporations in which each corporation is a majority shareholder of another corporation in the chain, ending in a corporation identified in paragraph (e)(5)(ii)(A)(1) or (2) of this section.

(B) Majority shareholder. For purposes of this paragraph (e)(5)(ii), a majority shareholder is a
shareholder owning more than 50 percent of the total fair market value and total voting power of such corporation.

(C) Example. The following example illustrates the rules of this paragraph (g)(5)(ii):

Example. Corporation A is a majority shareholder of Corporation B, which is a majority shareholder of Corporation C. A change in ownership of Corporation B constitutes a change in control event to service providers performing services for Corporation B or Corporation C, and to service providers for which Corporation B or Corporation C is solely liable for payments under the plan (for example, former employees), but is not a change in control event as to Corporation A or any other corporation of which Corporation A is a majority shareholder. Notwithstanding the foregoing, a sale of Corporation B may constitute an independent change in control event for Corporation A, Corporation B and Corporation C if unless the sale constitutes a change in the ownership of a substantial portion of Corporation A’s assets (see paragraph (g)(5)(vii) of this section).

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

(iv) Special rules for certain delayed payments pursuant to a change in control event. Compensation payable pursuant to the purchase by the service recipient of service recipient stock or — (A) Certain transaction-based compensation. Payments of compensation related to a change in control event described in paragraph (i)(5)(v) of this section (change in the ownership of a corporation) or paragraph (i)(5)(vii) of this section (change in the ownership of a substantial portion of a corporation’s assets), that occur because a service recipient purchases its stock held by the service provider or because the service recipient or a third party purchases a stock right held by a service provider, or payment of amounts of deferred compensation that are calculated by reference to the value of stock of the service recipient
stock (collectively, transaction-based compensation), may be treated as paid at a specified time designated date or pursuant to a fixed payment schedule in conformity that complies with the requirements of section 409A if the transaction-based compensation is paid on the same schedule and under the same terms and conditions as apply to payments to shareholders generally with respect to stock of the service recipient pursuant to a change in control event described in paragraph (g)(5)(v) of this section (change in the ownership of a corporation) or as apply to payments to the service recipient pursuant to a change in control event described in paragraph (g)(5)(vii) of this section (change in the ownership of a substantial portion of a corporation’s assets), and any amounts paid pursuant to such a schedule and such terms and conditions will not be treated as violating the initial or subsequent deferral elections rules, to the extent that such amounts are to the extent that the transaction-based compensation is paid not later than five years after the change in control event, the payment of such compensation will not violate the initial or subsequent deferral election rules set out in §1.409A-2(a) and (b) solely as a result of such transaction-based compensation being paid pursuant to such schedule and terms and conditions. If before and in connection with a change in control event described in paragraph (i)(5)(v) or (i)(5)(vii) of this section, transaction-based compensation that would otherwise be payable as a result of such event is made subject to a condition on payment that constitutes a substantial risk of forfeiture (as defined in §1.409A-1(d), without regard to the provisions of that section under which additions or extensions of forfeiture conditions are disregarded) and the transaction-based compensation is payable under the same terms and conditions as apply to payments made to shareholders generally with respect to stock of the service recipient pursuant to a change in control event described in paragraph (i)(5)(v) of this section or to payments to the service recipient pursuant to a change in control event described in paragraph (i)(5)(vii) of this section, for purposes of determining whether such transaction-based compensation is a short-term deferral the requirements of §1.409A-1(b)(4) are applied as if the legally binding right to such transaction-based compensation arose on the date that it became subject to such substantial risk of forfeiture.

(v) Change in the ownership of a corporation
(B) Certain nonvested compensation. Notwithstanding the provisions of §1.409A-1(d) (definition of a substantial risk of forfeiture) that disregard the extension or modification of a condition for purposes of determining whether a condition on payment constitutes a substantial risk of forfeiture, a condition that is a substantial risk of forfeiture that otherwise would lapse as a result of a change in control event described in paragraph (i)(5)(v) or (i)(5)(vii) of this section may be extended or modified before and in connection with such event to provide for a condition on payment that will not lapse as a result of such change in control event, and such extended or modified condition will be treated as continuing to subject the amount to a substantial risk of forfeiture, provided that the transaction constituting the change in control event is a bona fide arm’s length transaction between the service recipient or its shareholders and one or more parties who are unrelated to the service recipient and service provider (applying the rules of §1.409A-1(f)(2)(ii)) and the modified or extended condition to which the payment is subject would otherwise be treated as a substantial risk of forfeiture under §1.409A-1(d) (without regard to the provisions disregarding additions or extensions of forfeiture conditions). In such a case, the continued application of a fixed schedule of payments based upon the lapse of the substantial risk of forfeiture, so that payments commence upon the lapse of the modified or extended condition on payment, will not be treated as a change in the fixed schedule of payments for purposes of §1.409A-2(b) (subsequent deferral elections) or paragraph (i) of this section (prohibition on the acceleration of payments).

(v) Change in the ownership of a corporation--(A) In general. For purposes of section 409A, except as provided in paragraph (i)(5)(vi)(C) of this section, a change in the ownership of a corporation occurs on the date that any one person, or more than one person acting as a group (as defined in paragraph (g)(5)(v)(B) of this section), acquires ownership of stock of the corporation that, together with stock held by such person or group, constitutes more than 50 percent of the total fair market value or total voting power of the stock of such corporation. A nonqualified deferred compensation plan
may provide that amounts payable upon a change in the ownership of a corporation will be paid only if the conditions in the preceding sentence are satisfied but substituting a percentage specified in the plan that is higher than 50 percent for the words “50 percent” in the preceding sentence, but only if the provision is set forth in the plan no later than the date by which the time and form of payment must be established under §1.409A-2.

However, if any one person, or more than one person acting as a group, is considered to own more than 50 percent of the total fair market value or total voting power of the stock of a corporation (or such higher percentage specified in accordance with the preceding sentence), the acquisition of additional stock by the same person or persons is not considered to cause a change in the ownership of the corporation (or to cause a change in the effective control of the corporation (within the meaning of paragraph (g)(5)(vi) of this section)). An increase in the percentage of stock owned by any one person, or persons acting as a group, as a result of a transaction in which the corporation acquires its stock in exchange for property will be treated as an acquisition of stock for purposes of this section. This section applies only when there is a transfer of stock of a corporation (or issuance of stock of a corporation) and stock in such corporation remains outstanding after the transaction (see paragraph (g)(5)(vii) of this section for rules regarding the transfer of assets of a corporation). See §1.280G-1, Q&A-27(d), Example 1, Example 2, Example 5, and Example 6.

(B) Persons acting as a group. For purposes of paragraph (g)(5)(v)(A) of this section, persons will not be considered to be acting as a group solely because they purchase or own stock of the same corporation at the same time, or as a result of the same public offering. However, persons will be considered to be acting as a group if they are owners of a corporation that enters into a merger, consolidation, purchase or acquisition of stock, or similar business transaction with the corporation. If a person, including an entity, owns stock in both corporations that enter into a merger, consolidation, purchase or acquisition of stock, or similar transaction, such shareholder is considered to be acting as a group with other shareholders in a only with respect to the ownership in that corporation. If a person, including an entity, owns stock in both corporations that enter into a merger, consolidation, purchase or acquisition of stock, or similar transaction, such shareholder is considered to be acting as a group with other shareholders only with respect to the ownership in that corporation before the transaction giving rise to the
(vi) Change in the effective control of a corporation

(A) Change in the effective control of a corporation—(A)
In general. For purposes of section 409A, notwithstanding that a corporation has not undergone a change in ownership under paragraph (g)(5)(v) of this section, a change in the effective control of a corporation occurs only on the date that either of the following dates:

1. Any person, or more than one person acting as a group (as determined under paragraph (g)(5)(v)(B) of this section), acquires (or has acquired during the 12-month period ending on the date of the most recent acquisition by such person or persons) ownership of stock of the corporation possessing 35 percent or more of the total voting power of the stock of such corporation; or

2. A majority of members of the corporation’s board of directors is replaced during any 12-month period by directors whose appointment or election is not endorsed by a majority of the members of the corporation’s board of directors prior to the date of the appointment or election, provided that for purposes of this paragraph (g)(5)(vi)(A) the term corporation refers solely to the relevant
corporation identified in paragraph (g)(5)(ii) of this section, for which no other corporation is a majority shareholder for purposes of that paragraph. For example, if Corporation A is a publicly held corporation with no majority shareholder, and Corporation A is the majority shareholder of Corporation B, which is the majority shareholder of Corporation C, the term corporation for purposes of this paragraph (g)(5)(vi)(A)(2) would refer solely to Corporation A. A nonqualified deferred compensation plan may provide that amounts payable upon a change in the effective control of a corporation will be paid only if the conditions in the first sentence of this paragraph are satisfied substituting a portion of the members of the corporation’s board of directors that is higher than the words “a majority of the members of the corporation’s board of directors” in the first sentence of this paragraph, but only if the higher portion is set forth in the plan no later than the date by which the time and form of payment must be established under §1.409A-2(a)).

(B) **Multiple change in control events.** A change in effective control also may occur in any transaction in which either one of the two corporations involved in the transaction has a change in control event under paragraphs (i)(5)(v) or (g)(5)(vii) of this section. Thus, for example, assume Corporation P transfers more than 40 percent of the total gross fair market value of its assets to Corporation O in exchange for 35 percent of O’s stock. P has undergone a change in ownership of a substantial portion of its assets under paragraph (g)(5)(vii) of this section and O has a change in effective control under this paragraph (g)(5)(vi) of this section.

(C) **Acquisition of additional control.** If any one person, or more than one person acting as a group, is considered to effectively control a corporation (within the meaning of this paragraph (g)(5)(vi)), the acquisition of additional control of the
corporation by the same person or persons is not considered to cause a change in the effective control of the corporation (or to cause a change in the ownership of the corporation within the meaning of paragraph (g)(5)(v) of this section).

(D) Persons acting as a group. Persons will not be considered to be acting as a group solely because they purchase or own stock of the same corporation at the same time, or as a result of the same public offering. However, persons will be considered to be acting as a group if they are owners of a corporation that enters into a merger, consolidation, purchase or acquisition of stock, or similar business transaction with the corporation. If a person, including an entity, owns stock in both corporations that enter into a merger, consolidation, purchase or acquisition of stock, or similar transaction, such shareholder is considered to be acting as a group with other shareholders in a corporation only with respect to the ownership in that corporation prior to the transaction giving rise to the change and not with respect to the ownership interest in the other corporation. See § 1.280G-1, Q&A-27(d), Example 4.

(vii) Change in the ownership of a substantial portion of a corporation’s assets—

(A) In general. Change in the ownership of a substantial portion of a corporation’s assets—For purposes of section 409A, a change in the ownership of a substantial portion of a corporation’s assets occurs on the date that any one person, or more than one person acting as a group (as determined in paragraph (g)(5)(v)(B) of this section), acquires (or has acquired during the 12-month period ending on the date of the most recent acquisition by such person or persons) assets from the corporation that have a total gross fair market value equal to or more than 40 percent of the total gross fair market value of all of the assets of the corporation immediately prior to such acquisition or acquisitions and not with respect to the ownership interest in the other corporation. See § 1.409A-2). For this purpose, gross fair
market value means the value of the assets of the corporation, or the value of the assets being disposed of, determined without regard to any liabilities associated with such assets.

(B) **Transfers to a related person**

(B) (1) **Transfers to a related person**—(1) There is no change in control event under this paragraph (g(i)(5)(vii) when there is a transfer to an entity that is controlled by the shareholders of the transferring corporation immediately after the transfer, as provided in this paragraph (g(i)(5)(vii)(B). A transfer of assets by a corporation is not treated as a change in the ownership of such assets if the assets are transferred to—

(i) A shareholder of the corporation (immediately before the asset transfer) in exchange for or with respect to its stock;

(ii) An entity, 50 percent or more of the total value or voting power of which is owned, directly or indirectly, by the corporation;

(iii) A person, or more than one person acting as a group, that owns, directly or indirectly, 50 percent or more of the total value or voting power of all the outstanding stock of the corporation; or

(iv) An entity, at least 50 percent of the total value or voting power of which is owned, directly or indirectly, by a person described in paragraph (g(i)(5)(vii)(B)(1)(iii) of this section.

(2) For purposes of this paragraph (g(i)(5)(vii)(B) and except as otherwise provided in this paragraph (i), a person’s status is determined immediately after the transfer of the assets. For example, a transfer to a corporation in which the transferor corporation has no ownership
(C) **Persons acting as a group.** Persons will not be considered to be acting as a group solely because they purchase assets of the same corporation at the same time. However, persons will be considered to be acting as a group if they are owners of a corporation that enters into a merger, consolidation, purchase or acquisition of assets, or similar business transaction with the corporation. If a person, including an entity shareholder, owns stock in both corporations that enter into a merger, consolidation, purchase or acquisition of assets, or similar transaction, such shareholder is considered to be acting as a group with other shareholders in a corporation only to the extent of the ownership in that corporation prior to the transaction giving rise to the change and not with respect to the ownership interest in the other corporation. See §1.280G-1, Q&A-27(d), Example 4.

(6) **Certain back-to-back arrangements**

(6) **(i) Certain back-to-back arrangements**—In general. Notwithstanding the generally applicable limitations on payments described under paragraph (a) of this section, an arrangement between a service recipient and a service provider that is also a service recipient (a service provider/service recipient) may provide for a payment to the service provider to the intermediate service recipient are closely related to the services provided by the intermediate service recipient to the ultimate service recipient, there is a nonqualified deferred compensation plan providing for payments by the ultimate service recipient to the intermediate service recipient (the ultimate service recipient plan), there is a nonqualified deferred compensation plan or other agreement, method, program, or other arrangement providing for payments of compensation by the intermediate service recipient to the service provider (the intermediate service recipient plan), and the intermediate service recipient plan provides for a payment upon the occurrence of a payment event described in paragraph (a)(1), (2), (3), (5) or (6) of this section, where.

In such a case, notwithstanding the generally applicable limits on payments in paragraph (a) of this section, the ultimate service recipient plan may provide for a payment to the intermediate service recipient upon the occurrence of a payment event under the intermediate service recipient plan described in paragraph (a)(1), (2), (3),
(5), or (6) of this section if the time and form of payment is defined as the same time and form of payment provided under an arrangement subject to section 409A between the service provider/service recipient and a specified service provider to the service provider/service recipient, if the arrangement between the service provider/service recipient and the service recipient expressly provides for such time and form of payment and otherwise satisfies the intermediate service recipient plan, the amount of the payment under the ultimate service recipient plan does not exceed the amount of the payment under the intermediate service recipient plan, and the ultimate service recipient plan and the intermediate service recipient plan otherwise satisfy the requirements of section 409A (regardless of whether such plan is subject to section 409A).

(ii) Example. The provisions of this paragraph (g)(6)(i) of this section are illustrated by the following example:

Example. Company B (service provider/intermediate service recipient) provides services to Company C (ultimate service recipient). Employee A (service provider) provides services to Company B that are closely related to the services Company B provides to Company C. Pursuant to a nonqualified deferred compensation plan meeting the requirements of section 409A, Employee A is entitled to a payment of deferred compensation upon a separation from service with Company B (the intermediate service recipient plan). Under an arrangement between Company B and Company C (the ultimate service recipient plan), Company C agrees to pay an amount of deferred compensation to Company B upon Employee A’s separation from service with Company B, in accordance with the time and form of payment provided in the nonqualified deferred compensation plan between Employee A and Company B (the intermediate service recipient plan). Provided that the arrangement between Company B and Company C and the arrangement between Employee A and Company B otherwise comply with the requirements of section 409A (regardless of whether such arrangements are subject to section 409A), Company C’s payment to Company B of the amount due under the ultimate service recipient plan upon the separation from service of Employee A from Company B may constitute a permissible payment event for purposes of paragraph (a) of this section.

(h) — Prohibition on acceleration of payments—

(i) (1) Prohibition on acceleration of payments—(1) In general. Except as provided in paragraph (h)(2) of this section, an arrangement that is, or constitutes part of, a nonqualified deferred compensation plan may not permit the acceleration of the time or schedule of any payment or amount scheduled to be paid pursuant to a payment under the arrangement the terms of the plan, and no such accelerated payment may be made whether or not provided for under the terms of such plan. For purposes of determining whether a payment of deferred compensation has been made, the rules of paragraph (f) of this section (substituted payments) apply. For purposes of this paragraph (h), an impermissible acceleration does not occur if payment is made in accordance with plan provisions or an election as to the time and form of payment in effect at the time of initial deferral (or added in accordance with the rules applicable to
subsequent deferral elections under § 1.409A-2(b)) pursuant to which payment is
required to be made on an accelerated schedule as a result of an intervening event that is
an event described in paragraph (a)(1), (2), (3), (5), or (6) of this section. For example, a
plan may provide that a participant will receive six installment payments commencing at
separation from service, and also provide that if the participant dies after such payments
commence but before all payments have been made, all remaining amounts will be paid
in a lump sum payment. Additionally, it is not an acceleration of the time or schedule of
payment of a deferral of compensation if a service recipient waives or accelerates the
satisfaction of a condition constituting a substantial risk of forfeiture applicable to such
deferral of compensation, provided that the requirements of section 409A (including the
requirement that the payment be made upon a permissible payment event) are otherwise
satisfied with respect to such deferral of compensation. For example, if a nonqualified
deferred compensation arrangement provides for a lump sum payment of the vested
benefit upon separation from service, and the benefit vests under the plan only after 10
years of service, it is not a violation of the requirements of section 409A if the service
recipient reduces the vesting requirement to five years of service, even if a service
provider becomes vested as a result and receives a payment in connection with a
separation from service before the service provider would have completed 10 years of
service. However, if the plan in this example had provided for a payment at a fixed date,
rather than at separation from service, the date of payment could not be accelerated due to
the accelerated vesting. For the definition of a payment for purposes of this paragraph
(i), see §1.409A-2(b)(5) (coordination of the subsequent deferral election rules with the
prohibition on acceleration of payments). For other permissible payments, see §1.409A-
2(b)(2)(iii) (certain immediate payments of remaining installments) and paragraph (d) of
this section (certain payments made no more than 30 days before the designated payment
date).

(2) Application to multiple payment events. Generally, the addition of
a permissible payment event, the deletion of a permissible payment event, or the
substitution of one permissible payment event for another permissible payment event,
results in an acceleration of a payment if the addition, deletion, or substitution could
result in the payment being made at an earlier date than such payment would have been
made absent such addition, deletion, or substitution. Notwithstanding the previous
sentence, the addition of death, disability (as defined in paragraph (i)(4) of this section),
or an unforeseeable emergency (as defined in paragraph (i)(3) of this section), as a
potentially earlier alternative payment event to an amount previously deferred will not be
treated as resulting in an acceleration of a payment, even if such addition results in the
payment being paid at an earlier time than such payment would have been made absent
the addition of the payment event. However, the addition of such a payment event as a
potentially later alternative payment event generally is subject to the rules governing
changes in the time and form of payment (see §1.409A-2(b)).

(3) Beneficiaries. The rules of this paragraph (i) apply to elections by
beneficiaries with respect to the time and form of payment, as well as elections by service
providers or service recipients with respect to the time and form of payment to
beneficiaries. An election to change the identity of a beneficiary does not constitute an
acceleration of a payment merely because the election changes the identity of the
recipient of the payment, if the time and form of the payment is not otherwise changed. In addition, an election before the commencement of a life annuity to change the identity of a beneficiary does not constitute an acceleration of a payment if the change in the time of payments stems solely from the different life expectancy of the new beneficiary, such as in the case of a joint and survivor annuity, and does not change the commencement date of the life annuity.

(4) (2) Exceptions—(i) In general. Except as otherwise expressly provided, a plan may provide for the acceleration of a payment in accordance with paragraphs (j)(4)(ii) through (xiv) of this section, or may provide a service recipient discretion to accelerate payments in accordance with the provisions of paragraphs (j)(4)(ii) through (xiv) of this section. A plan may not provide a service provider discretion with respect to whether a payment will be accelerated, and a service recipient may not provide a service provider a direct or indirect election as to whether the service recipient’s discretion to accelerate a payment will be exercised, even if such acceleration would be permitted under paragraphs (j)(4)(ii) through (xiv) of this section. Whether a service recipient has provided a service provider an election as to whether the service recipient’s discretion to accelerate a payment will be exercised is determined based on all the facts and circumstances, including whether similarly situated service providers have been treated differently. Except as otherwise provided in paragraphs (j)(4)(ii) through (xiv) of this section, the plan need not set forth the exception in writing, and provided all other requirements of this section are met, the making of such a payment or the addition of a plan term permitting the making of such a payment will not constitute the acceleration of a payment, and the failure to make such a payment or the deletion or modification of a plan term permitting the making of such a payment will not be subject to the rules regarding a change in the time and form of payment under §1.409A-2(b).

(ii) (i) Domestic relations order. An arrangement may permit such acceleration of the time or schedule of a payment under the arrangement to an individual other than the service provider as may be necessary to fulfill a domestic relations order (as defined in section 414(p)(1)(B)).

(ii) Conflicts of interest. An arrangement may permit such acceleration of the time or schedule of a payment under the arrangement as may be necessary to comply with a certificate of divestiture (as defined in section 1043(b)(2)).

(iii) Conflicts of interest—(A) Compliance with ethics agreements with the Federal government. A plan may provide for acceleration of the time or schedule of a payment under the plan, or a payment may be made under a plan, to the extent necessary for any Federal officer or
employee in the executive branch to comply with an ethics agreement with the Federal government.

(B) Compliance with ethics laws or conflicts of interest laws. A plan may provide for acceleration of the time or schedule of a payment under the plan, or a payment may be made under a plan, to the extent reasonably necessary to avoid the violation of an applicable Federal, state, local, or foreign ethics law or conflicts of interest law (including where such payment is reasonably necessary to permit the service provider to participate in activities in the normal course of his or her position in which the service provider would otherwise not be able to participate under an applicable rule). A payment is reasonably necessary to avoid the violation of a Federal, state, local, or foreign ethics law or conflicts of interest law if the payment is a necessary part of a course of action that results in compliance with a Federal, state, local, or foreign ethics law or conflicts of interest law. For this purpose, a provision of foreign law is considered applicable only to foreign earned income (as defined under section 911(b)(1) without regard to section 911(b)(1)(B)(iv) and without regard to the requirement that the income be attributable to services performed during the period described in section 911(d)(1)(A) or (B)) from sources within the foreign country that promulgated such law.

(iv) Section 457 plans. An arrangement subject to section 457(f) may provide for an acceleration of the time or schedule of a payment to a service provider, or a payment may be made under such a plan, to pay Federal, state, local, and foreign income taxes due upon a vesting event, provided that the amount of such payment is not more than an amount equal to the Federal, state, local, and foreign income tax withholding that would have been remitted by the employer if there had been a payment of wages equal to the income includible by the service provider under section 457(f) at the time of the vesting.
(iv) — De minimis and specified amounts —

(v) (A) In general—An arrangement that does not otherwise provide for limited cashouts. A plan may require or provide a service recipient discretion to require (or be amended to require or to provide a service recipient discretion to require), a mandatory lump sum payment of benefits payment of amounts deferred under the plan that do not exceed a specified amount may be amended to permit the acceleration of the time or schedule of a payment to a service provider under the arrangement, provided that — provided that such plan term or amendment is executed and effective, and any required exercise of service recipient discretion is evidenced in writing, no later than the date of such payment, and provided that —

(A) (1) The payment accompanies and results in the termination and liquidation of the entirety of the service provider’s interest in the arrangement, and all similar arrangements that would constitute under the plan, including all agreements, methods, programs, or other arrangements with respect to which deferrals of compensation are treated as having been deferred under a single nonqualified deferred compensation plan under § 1.409A-1(c)(2); and

(2) The payment is made on or before the later of December 31 of the calendar year in which occurs the service provider’s separation from service from the service recipient, or the 15th day of the third month following the service provider’s separation from service from the service recipient;

(B) (3) The payment is not greater than $10,000; and the applicable dollar amount under section 402(g)(1)(B).

(4) The participant is provided no election with respect to receipt of the lump sum payment.

(B) — Prospective deferrals—An amendment described in paragraph (h)(2)(iv)(A) of this section may be made with respect to previously deferred amounts under the arrangement as well as amounts to be deferred
in the future. In addition, a nonqualified deferred compensation arrangement that otherwise complies with section 409A may provide, or be amended with regard to future deferrals to provide, that, if a service provider’s interest under the arrangement has a value below an amount specified by the plan at the time that amounts are payable under the plan, then the service provider’s entire interest under the plan must be distributed as a lump sum payment. However, once such a payment feature applies to an amount deferred, any change or elimination of such feature is subject to the rules governing changes in the time and form of payment.

(vi) **Payment of employment taxes.** An arrangement plan may provide for the acceleration of the time or schedule of a payment, or a payment may be made under the plan, to pay the Federal Insurance Contributions Act (FICA) tax imposed under section 3101, section 3121(a), and section 3121(v)(2), or the Railroad Retirement Act tax imposed under section 3201, section 3211, section 3231(e)(1), and section 3231(e)(8), where applicable, on compensation deferred under the arrangement plan (the FICA Amount or RRTA amount). Additionally, an arrangement plan may provide for the acceleration of the time or schedule of a payment, or a payment may be made under the plan, to pay the income tax at source on wages imposed under section 3401 or the corresponding withholding provisions of applicable state, local, or foreign tax laws as a result of the payment of the FICA Amount or RRTA amount, and to pay the additional income tax at source on wages attributable to the pyramiding section 3401 wages and taxes. However, the total payment under this acceleration provision must not exceed the aggregate of the FICA or RRTA Amount, and the income tax withholding related to such FICA Amount or RRTA Amount.

(vii) **Payments upon income inclusion under section 409A.** An arrangement plan may provide for the acceleration of the time or schedule of a payment to a service provider, or a payment under such plan may be made, at any time the arrangement plan fails to meet the requirements of section 409A and these regulations. Such payment may not exceed the amount required to be included in income as a result of the failure
to comply with the requirements of section 409A and these regulations.

(viii) (vii) Cancellation of deferrals following an unforeseeable emergency or hardship distribution. An arrangement plan may provide for a cancellation of a service provider’s deferral election, or such a cancellation may be made, due to an unforeseeable emergency or a hardship distribution pursuant to § 1.401(k)-1(d)(3). The deferral election must be cancelled, and not merely postponed or otherwise delayed. Accordingly, such that any later deferral election will be subject to the provisions governing initial deferral elections. See § 1.409A-2(a).

(ix) (viii) Arrangement Plan terminations and liquidations. An arrangement plan may permit an arrangement plan to terminate and liquidate the plan within 12 months of a corporate dissolution taxed under section 331, or with the approval of a bankruptcy court pursuant to 11 U.S.C. § 503(b)(1)(A), provided that the amounts deferred under the plan are included in the participants’ gross incomes in the latest of— the following years (or, if earlier, the taxable year in which the amount is actually or constructively received).

(A) The service recipient’s discretion under the arrangement plan to terminate the arrangement plan within 12 months of a corporate dissolution taxed under section 331, or with the approval of a bankruptcy court pursuant to 11 U.S.C. § 503(b)(1)(A), provided that the amounts deferred under the plan are included in the participants’ gross incomes in the latest of— the following years (or, if earlier, the taxable year in which the amount is actually or constructively received).

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

(2) The first calendar year in which the plan termination and liquidation occurs. (2) The first calendar year in which the amount is no longer subject to a substantial risk of forfeiture;

(3) The first calendar year in which the payment is administratively practicable.
(B) The service recipient’s discretion under the terms of the arrangement to terminate the arrangement, termination and liquidation of the plan pursuant to irrevocable action taken by the service recipient within the 30 days preceding or the 12 months following a change in control event (as defined in §1.409A-2(g)(4) paragraph (i)(5). For purposes of this section, provided that this paragraph (h)(2)(viii), an arrangement will be treated as terminated only if all substantially similar arrangements sponsored by the service recipient are terminated, so that the participant in the arrangement and immediately after the time of the change in control event with respect to which deferrals of compensation are treated as having been deferred under a single plan under §1.409A-1(c)(2) are terminated and liquidated with respect to each participant that experienced the change in control event, so that under the terms of the termination and liquidation all such participants under substantially similar arrangements are required to receive all amounts of compensation deferred under the terminated agreements, methods, programs, and other arrangements within 12 months of the date of termination of the arrangements, the service recipient irrevocably takes all necessary action to terminate and liquidate the agreements, methods, programs, and other arrangements. Solely for purposes of this paragraph (j)(4)(ix)(B), where the change in control event results from an asset purchase transaction, the applicable service recipient with the discretion to liquidate and terminate the agreements, methods, programs, and other arrangements is the service recipient that is primarily liable immediately after the transaction for the payment of the deferred compensation.

(C) The service recipient’s discretion under the terms of the arrangement to terminate the arrangement, provided that—

(1) The termination and liquidation does not occur proximate to a downturn in the financial health of the service recipient:
(2) All The service recipient terminates and liquidates all agreements, methods, programs, and other arrangements sponsored by the service recipient that would be aggregated with any terminated arrangement under § and liquidated agreements, methods, programs, and other arrangements under §1.409A-1(c) if the same service provider had deferrals of compensation under all of the agreements, methods, programs, and other arrangements that are terminated and liquidated:

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

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

(5) The service recipient does not adopt a new arrangement plan that would be aggregated with any terminated arrangement and liquidated plan under § 1.409A-1(c) if the same service provider participated in both arrangements plans, at any time within five years following the date of termination of the arrangement the service recipient takes all necessary action to irrevocably terminate and liquidate the plan.

(D) Such other events and conditions as the Commissioner may prescribe in generally applicable guidance published in the Internal Revenue Bulletin (see § 601.601(d)(2) of this chapter).
(ix) Certain distributions to avoid a nonallocation year under section 409(p). An arrangement A plan may provide for an acceleration of the time and form of a payment, or a payment may be made under such plan, to prevent the occurrence of a nonallocation year (within the meaning of section 409(p)(3)) in the plan year of the employee stock ownership plan next following the current plan year in which such payment is made, provided that the amount distributed may not exceed 125 percent of the minimum amount of distribution necessary to avoid the occurrence of a nonallocation year. Solely for purposes of determining permissible distributions under this paragraph (h)(24)(ix), synthetic equity (within the meaning of section 409(p)(6)(C) and §1.409(p)-1(f)) granted during the current plan year of the employee stock ownership plan plan year in which such payment is made is disregarded for purposes of determining whether the subsequent plan year would result in a nonallocation year.

(x) Payment of state, local, or foreign taxes. A plan may provide for an acceleration of the time and form of a payment, or a payment may be made under such plan, to reflect payment of state, local, or foreign tax obligations arising from participation in the plan that apply to an amount deferred under the plan before the amount is paid or made available to the participant (the state, local, or foreign tax amount). Such payment may not exceed the amount of such taxes due as a result of participation in the plan. Such payment may be made by distributions to the participant in the form of withholding pursuant to provisions of applicable state, local, or foreign law or by distribution directly to the participant. Additionally, an arrangement may provide for the acceleration of the time or schedule of payment, or a payment may be made under such arrangement, to pay the income tax at source on wages imposed under section 3401 as a result of such payment and to pay the additional income tax at source on wages imposed under section 3401 attributable to such additional section 3401 wages and taxes. However, the total payment under this acceleration provision must not exceed the aggregate of the state, local, and foreign tax amount, and the income tax withholding related to such state, local, and foreign tax amount.

(xii) Cancellation of deferral elections due to disability. A plan may provide for a cancellation of a service
provider’s deferral election, or a cancellation of such election may be made, where such cancellation occurs by the later of the end of the taxable year of the service provider or the 15th day of the third month following the date the service provider incurs a disability. For purposes of this paragraph, a disability refers to any medically determinable physical or mental impairment resulting in the service provider’s inability to perform the duties of his or her position or any substantially similar position, where such impairment can be expected to result in death or can be expected to last for a continuous period of not less than six months.

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

(xiv) Bona fide disputes as to a right to a payment. A plan may provide for the acceleration of the time or schedule of one or more payments, or a payment may be made under such plan, where such payments occur as part of a settlement between the service provider and the service recipient of an arm’s length, bona fide dispute as to the service provider’s right to the deferred amount. Discretion to accelerate payments, other than due to an arm’s length settlement of a bona fide dispute as to the service provider’s right to the deferred amount, is not permitted under this paragraph (j)(4)(xiv). Whether a payment qualifies for the exception under this paragraph is based on all relevant facts and circumstances. A payment will be presumed not to meet this exception unless the payment is subject to a substantial reduction in the value of the payment made in relation to the amount that would have been payable had there been no dispute as to the service provider’s right to the payment. For this purpose, a reduction that is less than 25 percent of the present value of the deferred amount in dispute generally is not a substantial reduction. In addition, a payment will be presumed not to meet this exception if the payment is
made proximate to a downturn in the financial health of the service recipient.

(5) Nonqualified deferred compensation arrangements linked to qualified employer plans—With respect to amounts deferred under an arrangement that is, or constitutes part of, or certain other arrangements. If a nonqualified deferred compensation plan, where under the terms of the nonqualified deferred compensation arrangement provides that the amount deferred under the plan is the amount determined under the formula determining benefits under a qualified employer plan (as defined in §1.409A-1(a)(2)), or a broad-based foreign retirement plan (as defined in §1.409A-1(a)(3)(v)) maintained by the service recipient but applied without regard to one or more limitations applicable to the qualified employer plan under the Internal Revenue Code or to the broad-based foreign retirement plan under other applicable law, or that the amount deferred under the nonqualified deferred compensation plan is determined as an amount offset by some or all of the benefits provided under the qualified employer plan, the operation of the qualified employer plan with respect to or broad-based foreign retirement plan, a decrease in amounts deferred under the nonqualified deferred compensation plan that results directly from changes in benefit limitations applicable to the qualified employer plan or the broad-based foreign retirement plan under the Internal Revenue Code or other applicable law, does not constitute an acceleration of a payment under the nonqualified deferred compensation arrangement regardless of whether such operation results in a decrease of amounts deferred under the nonqualified deferred compensation arrangement, provided that such operation does not otherwise result in a change in the time or form of a payment under the nonqualified deferred compensation plan, and provided further that the change in the amounts deferred under the nonqualified deferred compensation plan does not exceed such change in the amounts deferred under the qualified employer plan or the broad-based foreign retirement plan, as applicable. In addition, with respect to such a nonqualified deferred compensation arrangement, the following actions or failures to act will not constitute an acceleration of a payment under the nonqualified deferred compensation arrangement regardless of whether the nonqualified deferred compensation arrangement even if in accordance with the terms of the nonqualified deferred compensation arrangement, the actions or inactions result in a decrease in the amounts deferred under the arrangement, provided that such actions or inactions do not otherwise affect the time or form of payment under the nonqualified deferred compensation plan, and provided further that with respect to actions or inactions described in paragraphs (j)(5)(i) and (ii) of this section, the change in the amount deferred under the nonqualified deferred compensation plan does not exceed the change in the amounts deferred under the qualified employer plan or the broad-based foreign retirement plan, as applicable:

(i) A service provider’s action or inaction under the qualified employer plan or broad-based foreign retirement plan with respect to whether to elect to receive a subsidized benefit or an ancillary benefit under the qualified employer plan or broad-based foreign retirement plan.
(ii) The amendment of a qualified employer plan or broad-based foreign retirement plan to increase benefits provided under the qualified plan, or to add or remove a subsidized benefit or an ancillary benefit.

(iii) A service provider’s action or inaction with respect to an elective deferral election under a qualified employer plan subject to the contribution restrictions under section 401(a)(30) or section 402(g), including an adjustment to a deferral election made during a calendar year under such qualified employer plan, provided that for any given tax year, the service provider’s actions or inactions do not result in a decrease in the amounts deferred under all nonqualified deferred compensation plans in which the service provider participates (other than amounts described in paragraph (i)(5)(iv) of this section) in excess of the limit with respect to elective deferrals under section 402(g) in effect for the taxable year in which such action or inaction occurs.

(iv) A service provider’s action or inaction under a qualified employer plan with respect to elective deferrals and other employee pre-tax contributions subject to the contribution restrictions under section 401(a)(30) or section 402(g), and after-tax contributions by the service provider to a qualified employer plan that provides for such contributions, that affects the amounts that are credited under one or more nonqualified deferred compensation arrangement plans as matching amounts or other similar amounts contingent on service provider such elective deferrals, pre-tax contributions, or after-tax contributions, provided that the total of such matching or contingent amounts, as applicable, are either forfeited or never credited under the nonqualified deferred compensation arrangement in the absence of such service provider’s elective deferral or after-tax contribution, and provided further that for any given calendar year, the service provider’s actions and inactions do not result in a decrease in the amounts deferred under all nonqualified deferred compensation plans in which the service provider participates in excess of an amount equal to the limit with respect to elective deferrals under section 402(g) in effect for the taxable year in which such action or inaction occurs. See §1.409A-2(b)(6), Example 12.
and Example 13, never exceeds 100 percent of the matching or contingent amounts that would be provided under the qualified employer plan absent any plan-based restrictions that reflect limits on qualified plan contributions under the Internal Revenue Code.

Changes in elections under a cafeteria plan. A change in an election under a cafeteria plan (as defined in section 125(d)) does not result in an accelerated payment of an amount deferred under a nonqualified deferred compensation plan to the extent that the change in the amount deferred under the nonqualified deferred compensation plan results solely from the application of the change in amount eligible to be treated as compensation under the terms of the nonqualified deferred compensation plan resulting from the election change under the cafeteria plan, to a benefit formula under the nonqualified deferred compensation plan based upon the service provider’s eligible compensation, and only to the extent that such change applies in the same manner as any other increase or decrease in compensation would apply to such benefit formula.

§ 1.409A-4 Calculation of income inclusion. [Reserved].

§ 1.409A-5 Funding. [Reserved].

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

(a) Statutory application and effective dates—

(1) Application to amounts deferred—(i) In general. Except as otherwise provided in this section, section 409A applies with respect to amounts deferred in taxable years beginning after December 31, 2004, and with respect to amounts deferred in taxable years beginning before January 1, 2005, if the plan under which the deferral is made is materially modified after October 3, 2004. Section 409A is applicable for amounts deferred in taxable years beginning before January 1, 2005, under a plan that is materially modified after October 3, 2004, whether the plan complies with the requirements of section 409A and these regulations is determined by reference to the terms of the plan in effect as of, and any actions taken under the plan on or after, the date of the material modification. Section 409A is applicable with respect to earnings on amounts deferred only to the extent that section 409A is applicable with respect to the amounts deferred. Accordingly, section 409A applies with respect to earnings on amounts deferred before January 1, 2005, unless section 409A applies. For this purpose, a right to earnings that is subject to a substantial risk of forfeiture (as defined in §1.83-3(c)) or a requirement to perform further services, on an amount deferred that is not subject to a substantial risk of forfeiture (as defined in §1.83-3(c)) or a requirement to perform further services, is not treated as earnings on the amount deferred, but a separate right to compensation. Except as otherwise provided in applicable guidance (see §601.601(d)(2) of this chapter), the provisions of §§1.409A-1 through 1.409A-5 and this section provide the exclusive means of identifying agreements, methods, programs, or other
arrangements subject to section 409A, and the exclusive means of satisfying the requirements of section 409A with respect to such agreements, methods, programs, or other arrangements.

(ii) Collectively bargained plans. Section 409A does not apply with respect to amounts deferred under a plan maintained pursuant to one or more bona fide collective bargaining agreements in effect on October 3, 2004, for the period ending on the earlier of the date on which the last of such collective bargaining agreements terminates (determined without regard to any extension thereof after October 3, 2004) or December 31, 2009.

(2) Identification of date of deferral for statutory effective date purposes. For purposes of determining whether section 409A is applicable with respect to an amount, the amount is considered deferred before January 1, 2005, if before January 1, 2005, the service provider had a legally binding right to be paid the amount, and the right to the amount was earned and vested. For purposes of this paragraph (a)(2), a right to an amount was earned and vested only if the amount was not subject to a substantial risk of forfeiture (as defined in § 1.83-3) or a requirement to perform further services. Amounts to which the service provider did not have a legally binding right before January 1, 2005 (for example because the service recipient retained discretion to reduce the amount), will not be considered deferred before January 1, 2005. In addition, amounts to which the service provider had a legally binding right before January 1, 2005, but the right to which was subject to a substantial risk of forfeiture or a requirement to perform further services after December 31, 2004, are not considered deferred before January 1, 2005, for purposes of the effective date. Notwithstanding the foregoing, an amount to which the service provider had a legally binding right before January 1, 2005, but for which the service provider was required to continue performing services to retain the right only through the completion of the payroll period (as defined in § 1.409A-1(b)(3)) that includes December 31, 2004, is not treated as subject to a requirement to perform further services (or a substantial risk of forfeiture) for purposes of the effective date. For purposes of this paragraph (a)(2), a stock option, stock appreciation right, or similar compensation that on or before December 31, 2004, was immediately exercisable for cash or substantially vested property (as defined in § 1.83-3) is treated as earned and vested, regardless of whether the right would terminate if the service provider ceased providing services for the service recipient.

(3) Calculation of amount of compensation deferred for statutory effective date purposes—

(i) Nonaccount balance plans. The amount of compensation deferred before January 1, 2005, under a nonqualified deferred compensation plan that is a nonaccount balance plan (as defined in § 31.3121(v)(2) of this chapter) of the amount to which the service provider
would be entitled under the plan if the service provider voluntarily terminated services without cause on December 31, 2004, and received a payment of the benefits, with the maximum value, available from the plan on the earliest possible date allowed under the plan to receive a payment of benefits following the termination of services, and receive the benefits in the form with the maximum value. Notwithstanding the foregoing, for any subsequent calendar taxable year of the service provider, the grandfathered amount may increase to equal the present value of the benefit the service provider actually becomes entitled to, in the form and at the time actually paid, determined under the terms of the plan (including applicable limits under the Internal Revenue Code), as in effect on October 3, 2004, without regard to any further services rendered by the service provider after December 31, 2004, or any other events affecting the amount of or the entitlement to benefits (other than a participant election with respect to the time or form of an available benefit). For purposes of calculating the present value of a benefit under this paragraph (c)(3)(i), reasonable actuarial assumptions and methods must be used. Whether assumptions and methods are reasonable for this purpose is determined as of each date the benefit is valued for purposes of determining the grandfathered benefit, provided that any reasonable actuarial assumptions and methods that were used by the service recipient with respect to such benefit as of December 31, 2004, will continue to be treated as reasonable assumptions and methods for purposes of calculating the grandfathered benefit. Actuarial assumptions and methods will be presumed reasonable if they are the same as those used to value benefits under a qualified plan sponsored by the service recipient with respect to the benefits under which are part of the benefit formula under, or otherwise impact the amount of benefits under, the nonaccount balance nonqualified deferred compensation plan.

(ii) Account balance plans. The amount of compensation deferred before January 1, 2005, under a nonqualified deferred compensation plan that is an account balance plan (as defined in § 31.3121(v)(2)1.409A-1(c)(1)(ii) of this chapter) equals the portion of the service provider’s account balance as of December 31, 2004, the right to which is earned and vested (as defined in paragraph (a)(2) of this section) as of December 31, 2004, plus any future contributions to the account.
the right to which was earned and vested (as defined in paragraph (a)(2) of this section) as of December 31, 2004, to the extent such contributions are actually made.

(iii) Equity-based compensation plans. For purposes of determining the amounts deferred before January 1, 2005, under an equity-based compensation plan, the rules of paragraph (a)(3)(ii) of this section governing account balance plans are applied except that the account balance is deemed to be the amount of the payment available to the service provider on December 31, 2004 (or that would be available to the service provider if the right were immediately exercisable) the right to which is earned and vested (as defined in paragraph (a)(2) of this section) as of December 31, 2004. For this purpose, the payment available to the service provider excludes any exercise price or other amount that must be paid by the service provider.

(iv) Earnings. Earnings on amounts deferred under a plan before January 1, 2005, include only income (whether actual or notional) attributable to the amounts deferred under a plan as of December 31, 2004, or to such income. For example, notional interest earned under the plan on amounts deferred in an account balance plan as of December 31, 2004, generally will be treated as earnings on amounts deferred under the plan before January 1, 2005. Similarly, an increase in the amount of payment available pursuant to a stock option, stock appreciation right, or other equity-based compensation above the amount of payment available as of December 31, 2004, due to appreciation in the underlying stock after December 31, 2004, or accrual of other earnings such as dividends, is treated as earnings on the amount deferred. In the case of a nonaccount balance plan, earnings include the increase, due solely to the passage of time, in the present value of the future payments to which the service provider has obtained a legally binding right, the present value of which constituted the amounts deferred under the plan before January 1, 2005. Thus, for each year, there will be an increase (determined using the same interest rate used to determine the amounts deferred under the plan before January 1, 2005) 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 service provider’s survivorship during the year. However, an increase in
the potential benefits under a nonaccount balance plan due to, for example, an application of an increase in compensation after December 31, 2004, to a final average pay plan or subsequent eligibility for an early retirement subsidy, does not constitute earnings on the amounts deferred under the plan before January 1, 2005.

(v) Definition of plan. For purposes of this paragraph (a) paragraphs (a)(1), (2), and (3) of this section, the term “plan” has the same meaning provided in §1.409A-1(c), except that the provisions treating all nonaccount balance plans under which compensation is deferred as a single plan do not apply for purposes of the actuarial assumptions and methods used in paragraph (a)(3)(ii) of this section. Accordingly, different reasonable actuarial assumptions and methods may be used to calculate the amounts deferred by a service provider in two different arrangements each of which constitutes a nonaccount balance plan.

(4) Material modifications—

(i) In general. Except as otherwise provided, a modification of a plan is a material modification if a benefit or right existing as of October 3, 2004, is materially enhanced or a new material benefit or right is added, and such material enhancement or addition affects amounts earned and vested before January 1, 2005. Such material benefit enhancement or addition is a material modification whether it occurs pursuant to an amendment or to the service recipient’s exercise of discretion under the terms of the plan. For example, an amendment to a plan to add a provision that payments of deferred amounts earned and vested before January 1, 2005, may be allowed upon request if service providers are required to forfeit 20 percent of the amount of the payment (a haircut) would be a material modification to the plan. Similarly, a material modification would occur if a service recipient exercised discretion to accelerate vesting of a benefit under the plan to a date on or before December 31, 2004. However, it is not a material modification for a service recipient to exercise discretion over the time and manner of payment of a benefit to the extent such discretion is provided under the terms of the plan as of October 3, 2004. It is not a material modification for a service provider to exercise a right permitted under the plan as in
effect on October 3, 2004. The amendment of a plan to bring the plan into compliance with the provisions of section 409A will not be treated as a material modification. However, a plan amendment or the exercise of discretion under the terms of the plan that materially enhances an existing benefit or right or adds a new material benefit or right will be considered a material modification even if the enhanced or added benefit would be permitted under section 409A. For example, the addition of a right to a payment upon an unforeseeable emergency of an amount earned and vested before January 1, 2005, would be considered a material modification. The reduction of an existing benefit is not a material modification. For example, the removal of a haircut provision generally would not constitute a material modification. The establishment of or contributions to a trust or other arrangement from which benefits under the plan are to be paid is not a material modification of the plan, provided that the contribution to the trust or other arrangement would not otherwise cause an amount to be includible in the service provider’s gross income. The following modifications also are not material modifications for purposes of this paragraph (a)(4)(i):

(A) The establishment of or contributions to a trust or other arrangement from which benefits under the plan are to be paid is not a material modification of the plan, provided that the contribution to the trust or other arrangement would not otherwise cause an amount to be includible in the service provider’s gross income.

(B) The modification of a provision requiring the immediate cancellation of a current deferral election, to require the cancellation of deferrals for the same length of time beginning with the first date at which the application of such cancellation would not violate section 409A (for example, the first date of the service provider’s first taxable year following the cancellation).

(C) Compliance with a domestic relations order (as defined in §1.409A3(i)(4)(ii)) with respect to payments to an individual other than the service provider, or an amendment to a plan to require compliance with a domestic relations order with
respect to payments to an individual other than the service provider.

(D) The modification of a plan providing a life annuity form of payment to permit an election between the existing life annuity form of payment and other forms of annuity payments that would be treated as a single form of payment with the existing life annuity form of payment under §1.409A-2(b)(2)(ii).

(E) The modification of a grandfathered plan to add a limited cashout feature consistent with §1.409A-3(i)(4)(v) (exception to prohibition on accelerated payments).

(ii) Adoptions of new arrangements plans. It is presumed that the adoption of a new arrangement plan or the grant of an additional benefit under an existing arrangement plan after October 3, 2004, and before January 1, 2005, constitutes a material modification of a plan. However, the presumption may be rebutted by demonstrating that the adoption of the arrangement plan or grant of the additional benefit was consistent with the service recipient’s historical compensation practices. For example, the presumption that the grant of a discounted stock option on November 1, 2004, is a material modification of a plan may be rebutted by demonstrating that the grant was consistent with the historic practice of granting substantially similar discounted stock options (both as to terms and amounts) each November for a significant number of years. Notwithstanding paragraph (a)(4)(i) of this section and this paragraph (a)(4)(ii), the grant of an additional benefit under an existing arrangement plan that consists of a deferral of additional compensation not otherwise provided under the plan as of October 3, 2004, will be treated as a material modification of the plan only as to the additional deferral of compensation, if the plan explicitly identifies the additional deferral of compensation and provides that the additional deferral of compensation is subject to section 409A. Accordingly, amendments to conform a plan to the requirements of section 409A with respect to deferrals under a plan occurring after December 31, 2004, will not constitute a material modification of the plan with respect to amounts deferred that are earned and vested on or before December 31, 2004, provided that there is no concurrent material modification with respect to the amount of, or
rights to, amounts deferred that were earned and vested on or before December 31, 2004. Similarly, a grant of an additional benefit under a new arrangement plan adopted after October 3, 2004, and before January 1, 2005, will not be treated as a material modification of an existing plan to the extent that the new arrangement plan explicitly identifies additional deferrals of compensation and provides that the additional deferrals of compensation are subject to section 409A.

(iii) Suspension or termination of a plan. A cessation of deferrals under, or termination of, a plan, pursuant to the provisions of such plan, is not a material modification. Amending an arrangement to stop future deferrals thereunder is not a material modification of the arrangement or the plan. Amending an arrangement to provide participants an election whether to terminate participation in a plan generally constitutes a material modification of the plan.

(iv) Changes to investment measures—account balance plans. With respect to an account balance plan (as defined in §31.3121(v)(2)-1.409A-1(c)(1)(ii) of this chapter), it is not a material modification to change a notional investment measure, or to add to an existing investment measure, an investment measure that qualifies as a predetermined actual investment within the meaning of §31.3121(v)(2)-1(d)(2) of this chapter or, for any given taxable year, reflects a reasonable rate of interest (determined in accordance with §31.3121(v)(2)-1(d)(2)(i)(C) of this chapter). For this purpose, if with respect to an amount deferred for a period, a plan provides for a fixed rate of interest to be credited, and the rate is to be reset under the plan at a specified future date that is not later than the end of the fifth calendar taxable year that begins after the beginning of the period, the rate is reasonable at the beginning of the period, and the rate is not changed before the reset date, then the rate will be treated as reasonable in all future periods before the reset date.

(v) Stock rights. The modification, extension, or renewal of a stock right will not constitute a material modification of the stock right, if the modification, extension, or renewal would not be treated as the grant of a new stock right under §1.409A-1(b)(5)(v)(A), and would not result in the
stock right being treated as having had a deferral feature from the date of grant pursuant to §1.409A1(b)(5)(v)(C).

(vi) **Rescission of modifications.** Any modification to the terms of a plan that would inadvertently result in treatment as a material modification under this section is not considered a material modification of the plan to the extent the modification in the terms of the plan is rescinded by the earlier of a date before the right is exercised (if the change grants a discretionary right) or the last day of the calendar taxable year of the service provider during which such change occurred. Thus, for example, if a service recipient modifies the terms of a plan on March 1 to allow an election of individual employee to elect a new change in the time or form of payment without realizing that such a change constituted a material modification that would subject the plan to the requirements of section 409A, and the modification is rescinded on November 1, then if no change in the time or form of payment has been made pursuant to the modification before November 1, the plan is not considered materially modified under this section.

(vii) **Definition of plan.** For purposes of this paragraph (a)(4), the term “plan” has the same meaning provided in §1.409A-1(c), except that the provision treating all account balance plans under which compensation is deferred as a single plan, all nonaccount balance plans under which compensation is deferred as a separate single plan, all separation pay arrangements due to an actual involuntary separation from service or participation in a window program as a separate single plan, and all other nonqualified deferred compensation plans as a separate single plan, does not apply.

(b) **Regulatory applicability date.** §1.409A-1, §1.409A-2, §1.409A-3 and this section are applicable for taxable years beginning on or after January 1, 2008.