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Regs. §§ 1.409A-0 thru 1.411(d)-5

[Prop Reg §1.409A-4 Calculation of amount includible in income and additional income taxes.](#)

PAR. 3 Section 1.409A-4 is added to read as follows:

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

^N_SW+E (a) Amount includible in income due to failure to meet the requirements of section 409A(a).

^N_SW+E (1) *In general.*

^N_SW+E (i) Calculation formula. The amount includible in income for a service provider's taxable year due to a failure to meet the requirements of section 409A(a) with respect to a plan is the excess (if any) of—

^N_SW+E (A) The service provider's total amount deferred under the plan for the taxable year, including the amount of any payments of amounts deferred under the plan to (or on behalf of) the service provider during such taxable year; over

^N_SW+E (B) The portion of such amount, if any, that is either subject to a substantial risk of forfeiture (as defined in §1.409A-1(d) and applying paragraph (a)(1)(ii)(B) of this section) or has been previously included in income (as defined in §1.409A-4(a)(3)).

^N_SW+E (ii) Each taxable year analyzed independently.

^N_SW+E (A) In general. An amount is includible in income under section 409A(a) for a taxable year only if a plan fails to meet the requirements of section 409A(a) during such taxable year. Whether an amount is includible in income for a taxable year due to a failure to meet the requirements of section 409A(a) during such taxable year is determined independently of whether such amounts are also includible in income due to a failure to meet the requirements of section 409A(a) in a previous or subsequent taxable year. Accordingly, an amount may be includible in income for a

taxable year during which a plan fails to meet the requirements of section 409A(a), even if the same amount was includible in income in a previous taxable year, except to the extent provided in §1.409A-4(a)(3) (identification of amount previously included in income).

^N_W^E_S (B) Treatment of certain deferred amounts otherwise subject to a substantial risk of forfeiture. For purposes of determining the amount includible in income under section 409A(a) and paragraph (a)(1)(i) of this section, if the facts and circumstances indicate that a service recipient has a pattern or practice of permitting impermissible changes in the time and form of payment with respect to nonvested deferred amounts under one or more plans, an amount deferred under a plan that is otherwise subject to a substantial risk of forfeiture is not treated as subject to a substantial risk of forfeiture if an impermissible change in the time and form of payment (including an impermissible initial deferral election) applies to the amount deferred or if the facts and circumstances indicate that the amount deferred would be affected by such pattern or practice.

^N_W^E_S (iii) Examples. The following examples illustrate the provisions of this paragraph (a)(1). For each of the examples, Employee A is an individual taxpayer with a calendar year taxable year. Employee A has a total amount deferred under a nonqualified deferred compensation plan of \$0 in 2010, \$100,000 in 2011, and \$250,000 in 2012. No payments are made under the plan. The plan under which the amounts are deferred fails to meet the requirements of section 409A(a) during 2011 and 2012. The examples read as follows:

Example (1). With respect to Employee A, at no time is any deferred amount subject to a substantial risk of forfeiture. Employee A has \$100,000 includible in income under section 409A(a) for 2011, because no portion of the total deferred amount for 2011 is subject to a substantial risk of forfeiture or has previously been included in income. If that \$100,000 is included in income for 2011, Employee A has \$150,000 includible in income under section 409A(a) for 2012 because for the taxable year 2012 the \$100,000 is previously included in income (see paragraphs (a)(1)(i)(B) and (a)(3) of this section). If that \$100,000 is not included in income for 2011, Employee A has \$250,000 includible in income under section 409A(a) for 2012. Employee A does not avoid the requirement to include \$100,000 in income under section 409A(a) for 2011 by including \$250,000 in income under section 409A(a) for 2012.

Example (2). The same facts as Example 1, except that, with respect to Employee A, the statute of limitations on assessments has expired for 2011, but has not expired for 2012. Employee A has \$250,000 includible in income under section 409A(a) for 2012, because no portion of the total deferred amount for 2012 is subject

to a substantial risk of forfeiture or has previously been included in income.

^N_S ^W_E (2) *Identification of the portion of the total amount deferred for a taxable year that is subject to a substantial risk of forfeiture*


^N_S ^W_E (i) In general. The portion of the total amount deferred for a taxable year that is subject to a substantial risk of forfeiture (as defined in §1.409A-1(d)) is determined as of the last day of the service provider's taxable year. Accordingly, an amount may be includible in income under section 409A(a) for a taxable year even if such amount is subject to a substantial risk of forfeiture during the taxable year if the substantial risk of forfeiture lapses during such taxable year, including if the substantial risk of forfeiture lapses after the date the nonqualified deferred compensation plan under which the amount is deferred first fails to meet the requirements of section 409A(a).

^N_S ^W_E (ii) Example. The following example illustrates the provisions of this paragraph (a)(2): Employee B is an individual taxpayer with a calendar year taxable year. Employee B has a total amount deferred under a nonqualified deferred compensation plan of \$0 for 2010, \$100,000 for 2011, and \$250,000 for 2012. No payments are made under the plan. Under the terms of the plan, if Employee B voluntarily separates from service before July 1, 2012, Employee B will forfeit 50 percent of the Employee B's total amount deferred under the plan. If Employee B voluntarily separates from service after June 30, 2012 but before July 1, 2013, Employee B will forfeit 20 percent of the total amount deferred under the plan. If Employee B voluntarily separates from service after June 30, 2013, Employee B will not forfeit any amount deferred under the plan. As of December 31, 2011, 50 percent of the total amount deferred under the plan (\$50,000) is subject to a substantial risk of forfeiture, and the remaining amount deferred under the plan (\$50,000) is not subject to a substantial risk of forfeiture. As of December 31, 2012, 20 percent of the total amount deferred under the plan (\$50,000) is subject to a substantial risk of forfeiture, and the remaining amount deferred under the plan (\$200,000) is not subject to a substantial risk of forfeiture. At all times the terms of the plan meet the requirements of section 409A(a) and the applicable regulations, and through May 31, 2012, the plan is operated in a manner that complies with the terms of the plan. On June 1, 2012, the plan is operated in a manner that fails to meet the requirements of section 409A(a). For purposes of determining the amount includible in income under section 409A(a), except as provided in paragraph (a)(1)(ii)(B) of this section, the portion of the total amount deferred for 2012 that is subject to a substantial risk of forfeiture is \$50,000 (20 percent of \$250,000).

^N_S ^W_E (3) *Identification of amount previously included in income.*

^N_S ^W_E (i) In general. For purposes of this section, an amount is previously included in income only if the service provider has

included the amount in income under an applicable provision of the Internal Revenue Code for a previous taxable year. An amount is treated as included in income for a taxable year only to the extent that the amount was properly includible in income and the service provider actually included the amount in income (including on an original or amended return or as a result of an IRS examination or a final decision of a court of competent jurisdiction). For future taxable years, the amount previously included in income is reduced to reflect any amount that was paid during the taxable year for which the amount was included in income, any amount allocated to a payment made under the plan under paragraph (f) of this section, and any amount deductible under paragraph (g) of this section.

 (ii) Examples. The following examples illustrate the provisions of this paragraph (a)(3). For all of the examples, Employee C is an individual taxpayer with a calendar year taxable year. Employee C has a total amount deferred under a nonqualified deferred compensation plan of \$0 in 2010, \$100,000 in 2011, and \$250,000 in 2012. With respect to Employee C, the statute of limitations on assessments has not expired for 2011 or 2012. Except as otherwise explicitly provided in the following examples, Employee C has not included in income for 2011 on any original or amended tax return any amount deferred under the plan, none of the \$250,000 total amount deferred for 2012 has previously been included in income, no payments are made under the plan, and at no time is any deferred amount subject to a substantial risk of forfeiture. The plan under which the amounts are deferred fails to meet the requirements of section 409A(a) during 2011 and 2012. The examples read as follows:

Example (1). After filing an original Federal income tax return for 2011 that did not include any amount in income under section 409A(a), on April 1, 2013, Employee C files an amended Federal income tax return for 2011 and properly includes \$100,000 in income under section 409A(a) for 2011. For purposes of determining the amount includible in income under section 409A(a) for 2012, \$100,000 of the \$250,000 total amount deferred for 2012 has previously been included in income with respect to the plan. For 2012, Employee C includes in income \$150,000 under section 409A(a) on Employee C's original Federal income tax return. As of January 1, 2013, the amount that Employee C has previously included in income under section 409A(a) with respect to the plan is \$250,000.

Example (2). The facts are the same as in Example 1, except that Employee C receives a \$10,000 payment in 2011 so that the total amount deferred for 2012 is \$240,000. For purposes of determining the amount includible in income under section 409A(a) for 2012, the \$100,000 amount previously included in income is reduced by the \$10,000 payment so that \$90,000 of the \$240,000 total amount deferred for 2012 has previously been included in income. For 2012, Employee C includes in income \$150,000 under section 409A(a) on Employee C's original Federal income tax return. As of January 1, 2013, the amount that

Employee C has previously included in income under section 409A(a) with respect to the plan is \$240,000.

Example (3). The facts are the same as in Example 2. Due to deemed investment losses during 2013, Employee C has an \$80,000 total amount deferred under the plan for 2013. On December 31, 2013, Employee C's total amount deferred (\$80,000) is paid to Employee C as a single sum payment. Pursuant to paragraph (f) of this section, \$80,000 of the \$240,000 amount previously included in income is allocated to the \$80,000 payment so that none of the \$80,000 is includible in income. In addition, pursuant to paragraph (g) of this section, Employee C is entitled to deduct \$160,000 for 2013 equal to the remaining amount previously included in income the right to which is permanently lost. Because the entire \$240,000 amount previously included in income has been allocated to a payment under paragraph (f) of this section or was deductible under paragraph (g) of this section, no portion of such amount is treated as previously included in income for 2014 or any subsequent taxable year. As of January 1, 2014, the amount that Employee C has previously included in income under section 409A(a) with respect to the plan is \$0.

^N_S (b) The total amount deferred under a plan for a taxable year.

^N_S (1) *Application of general rules and specific rules for specific types of plans.* Paragraph (b)(2) of this section provides general rules governing the determination of the total amount deferred under a plan for a taxable year, including the treatment of plans providing for alternative times and forms of payment and plans providing for certain payments the amount of which is determined by a formula that includes one or more variables dependent upon future events (formula amounts). Paragraphs (b)(3) through (b)(6) of this section provide specific rules governing the determination of the total amount deferred under certain types of plans. Except as otherwise provided, any applicable rules of paragraphs (b)(3) through (b)(6) of this section are applied in conjunction with the general rules provided in paragraph (b)(2) of this section.

^N_S (2) *General definition of total amount deferred.*

^N_S (i) *General calculation rules.* Except as otherwise provided, the total amount deferred for a taxable year equals the present value of the future payments to which the service provider has a legally binding right under the plan as of the last day of the taxable year, plus the amount of any payments of amounts deferred under the plan to (or on behalf of) the service provider during such taxable year. For purposes of this section, present value means the value, as of a specified date, of an amount or series of amounts due thereafter, determined in accordance with the rules and assumptions of this paragraph (b)(2), as applicable, where each amount is multiplied by the probability that the condition or conditions on which payment of the amount is contingent will be satisfied, also determined in accordance with the rules and

assumptions set forth in this paragraph (b)(2), as applicable, discounted according to an assumed rate of interest to reflect the time value of money. For this purpose, a discount for the probability that an employee will die before commencement of benefit payments is permitted, but only to the extent that benefits will be forfeited upon death. In addition, the present value cannot be discounted for the probability that payments will not be made (or will be reduced) because of the unfunded status of the plan, the risk associated with any deemed or actual investment of amounts deferred under the plan, the risk that the service recipient, the trustee, or another party will be unwilling or unable to pay, the possibility of future plan amendments, the possibility of a future change in the law, or similar risks or contingencies. If the amount payable under a plan or the value of a benefit under a plan is expressed in a currency other than the U.S. dollar, the total amount deferred is translated from foreign currency into U.S. dollars at the spot exchange rate on the last day of the service provider's taxable year. No adjustment is made to the total amount deferred to reflect the risk that the currency in which the amount payable or the value of the benefit is expressed may in the future increase or decrease in value with respect to the U.S. dollar or any other currency.

$\frac{N}{S} + E$ (ii) Actuarial assumptions and methods.

$\frac{N}{S} + E$ (A) Requirement of reasonable actuarial assumptions and methods. For purposes of this section, the present value must be determined as of the last day of the service provider's taxable year using actuarial assumptions and methods that are reasonable as of that date, including an interest rate for purposes of discounting for present value that is reasonable as of that date.


$\frac{N}{S} + E$ (B) Use of an unreasonable actuarial assumption or method. If any actuarial assumption or method used to determine the total amount deferred for a taxable year under a plan is not reasonable, as determined by the Commissioner, then the total amount deferred is determined by the application of the AFR and, if applicable, the applicable mortality table under section 417(e)(3)(A)(ii)(I) (the 417(e) mortality table), both determined as of the last month of the taxable year for which the amount deferred is being determined. For purposes of this section, AFR means the appropriate applicable Federal rate (as defined pursuant to section 1274(d)) based on annual compounding, for the last month of the taxable year for which the amount includible in income is being determined. The period for which excess interest will be credited, beginning with the last day of the taxable year and ending with the date the excess interest will no longer be credited (determined in accordance with the payment timing assumptions set forth in paragraph (b)(2)(vi) and (vii) of this section) is used to determine the appropriate AFR (short-term, mid-term, or long-term).

^N_§ ^W₊ ^E (iii) Crediting of earnings and losses. The earnings and losses credited under a plan as of the last day of the service provider's taxable year pursuant to the plan are given effect only to the extent the plan's terms reasonably reflect the value of the service provider's rights under the plan. For example, a plan's method of determining the amount of such earnings or losses generally will be respected for purposes of determining the total amount deferred for the taxable year, provided that the earnings and losses are credited at least once per taxable year. If earnings and losses are not credited at least annually, the total amount deferred is calculated as if the earnings or losses were credited as of the last day of the taxable year. In addition, any change in the schedule for crediting earnings during the taxable year for which the total amount deferred is calculated that would reduce the earnings credited for a taxable year in which an amount is required to be included in income under section 409A(a) is disregarded for such taxable year. For example, if a plan is amended during a taxable year that is a calendar year to change the date for crediting earnings from December 31 to July 1 of that year and the plan fails to meet the requirements of section 409A(a) during that year, the amendment is disregarded for purposes of determining the total amount deferred for the year and December 31 is treated as the date for crediting earnings and losses. If no further changes are made to the plan with respect to the crediting of earnings and losses, for subsequent taxable years, July 1 is treated as the date for crediting earnings and losses.

^N_§ ^W₊ ^E (iv) Application of the general calculation rules to formula amounts.

^N_§ ^W₊ ^E (A) In general. With respect to a right to a payment to which this paragraph applies, the amount payable for purposes of determining the total amount deferred for the taxable year must be determined based on all of the facts and circumstances existing as of the close of the last day of the taxable year. Such determination must reflect reasonable, good faith assumptions with respect to any contingencies as to the amount of the payment, both with respect to each contingency and with respect to all contingencies in the aggregate. An assumption based on the facts and circumstances as of the close of the last day of a taxable year may be reasonable even if the facts and circumstances change in a subsequent year so that if the amount payable were determined for such subsequent year, the amount payable would be a greater (or lesser) amount. In such a case, the increase (or decrease) due to the change in the facts and circumstances is treated as earnings (or losses). This paragraph (b)(2)(iv) applies to the extent that the amount payable in a future taxable year is a formula amount to the extent that the amount payable in a future taxable year is dependent upon factors that, after applying the assumptions and other rules set out in this section, are not determinable as of the end of the taxable year for which the total amount deferred is being


calculated, so that the amount payable may not readily be determined as of the end of such taxable year under the other provisions of this section. If a portion of a deferred amount is determinable under the other rules of this paragraph (b)(2), the determination of the amount deferred with respect to such portion must be determined under the rules applicable to amounts that are not formula amounts, and only the balance of the deferred amount is determined under this paragraph.

 (B) Examples. The following examples illustrate the provisions of this paragraph (b)(2)(iv):

Example (1). On January 1, 2020, a service provider receives a legally binding right to a payment of one percent of the service recipient's net profits for the calendar years 2020, 2021, and 2022, payable on the later of January 1, 2024 or the service provider's separation from service. The amount payable is a formula amount and this paragraph (b)(2)(iv) applies.

Example (2). On January 1, 2020, a service provider receives a legally binding right to a payment of the greater of one percent of the service recipient's net profits for the calendar years 2020, 2021, and 2022 or \$10,000, payable on the later of January 1, 2024 or the service provider's separation from service. The portion of the amount payable that is a \$10,000 payment, payable at the later of January 1, 2024 or the service provider's separation from service, is not a formula amount. The portion of the amount payable that is the excess, if any, of one percent of the service recipient's net profits for the calendar years 2020, 2021, and 2022 over \$10,000 is a formula amount and this paragraph (b)(2)(iv) applies.

Example (3). On January 1, 2020, a service provider receives a legally binding right to payment equal to the value of 10,000 shares of service recipient stock, payable on the later of January 1, 2024 or the service provider's separation from service. Because the amount payable may increase or decrease only due to a change in value of a predetermined actual investment (10,000 shares of service recipient stock), the amount payable is not treated as a formula amount and this paragraph (b)(2)(iv) does not apply.

 (v) Treatment of payment restrictions. Except as specifically provided, a restriction on the payment of all or part of a deferred amount that will or may lapse under the terms of the plan, including a risk of forfeiture that is not a substantial risk of forfeiture as defined in §1.409A-1(d) or is disregarded under §1.409A-4(a)(1)(ii)(B), is ignored for purposes of determining the total amount deferred under the plan. Accordingly, in calculating the total amount deferred, there is no reduction to account for a

risk that the amount may be forfeited if the risk of forfeiture is not a substantial risk of forfeiture. For example, if an amount deferred is subject to forfeiture under a noncompetition provision applicable for a prescribed period, the forfeiture provision is disregarded for purposes of determining the total amount deferred for the taxable year.

^N_SW+E (vi) Treatment of alternative times and forms of a future payment.

^N_SW+E (A) In general. For purposes of determining the total amount deferred for a taxable year, if payment of a deferred amount may be made at alternative times or in alternative forms, each amount deferred under the plan is treated as payable at the time and under the form of payment for which the present value is highest. A time and form of payment is available to the extent a deferred amount under the plan may be payable in such time and form of payment under the plan's terms. If the service recipient has commenced payment of a deferred amount in a time and form of payment under the plan, or the service provider or service recipient has elected a time and form of payment under the plan, and under the plan's terms neither party can change such time and form of payment without the consent of the other party (and such consent requirement has substantive significance), the time and form of payment elected or the time and form of payment in which payments have commenced is treated as the sole available time and form of payment for such amount. If an alternative time and form of payment is available only at the service recipient's discretion, the time and form of payment is not available unless the service provider has a legally binding right under the principles of §1.409A-1(b)(1) to any additional value that would be generated by the service recipient's exercise of such discretion. For purposes of determining the value of each available time and form of payment, the assumptions and methods described in this paragraph (b)(2)(vi) are applied, and then the value of each available time and form of payment is determined in accordance with the other applicable rules provided in paragraph (b) of this section.

^N_SW+E (B) Effect of status of service provider on available times and forms of payment. For purposes of determining whether a time and form of payment is available, if eligibility for a time and form of payment depends upon the service provider's status as of a future date, the service provider is assumed to continue in the service provider's status as of the last day of the taxable year. However, if the eligibility requirement is not bona fide and does not serve a bona fide business purpose, the eligibility requirement will be disregarded and the service provider will be treated as eligible for the alternative time and form of payment. For this purpose, an eligibility condition based

upon the service provider's marital status (including status as a registered domestic partner or similar requirement), parental status, or status as a U.S. citizen or lawful permanent resident under section 7701(b)(6) is presumed to be bona fide and serve a bona fide business purpose. Notwithstanding the foregoing, if eligibility for a certain time or form of payment includes a bona fide requirement that the service provider provide additional services after the end of the taxable year, the time and form of payment is not treated as an available time and form of payment. The rules of this paragraph (b)(2)(vi)(B) apply regardless of whether the service provider's status changes during a subsequent taxable year.

^N_W⁺_E (vii) Treatment of payment triggers based upon events.

^N_W⁺_E (A) In general. For purposes of determining the total amount deferred for a taxable year, if a payment trigger has occurred on or before the last day of the taxable year, a deferred amount payable upon such trigger is treated as payable at the time the payment is scheduled to be made under the terms of the plan. If the payment trigger has not occurred on or before the last day of the taxable year, the trigger is treated as occurring on the earliest possible date the trigger reasonably could occur based on the facts and circumstances as of the last day of the taxable year, and the deferred amount is treated as payable based upon the schedule of payments that would be triggered by such occurrence. Notwithstanding the foregoing, if the payment trigger requires a separation from service, a termination of employment, or other similar reduction or cessation of services, the service provider is treated as meeting such requirement as of the last day of the taxable year. For purposes of determining the earliest date the payment trigger reasonably could occur, whether the payment trigger actually occurs in a subsequent taxable year is disregarded. For purposes of this paragraph (b)(2)(vii), a payment trigger means an event (not including the mere passage of time) upon which an amount may become payable. Generally if an amount would be payable in a different time and form of payment depending upon some characteristic of an event, each type of event upon which an amount would become payable is treated as a separate payment trigger. For example, if an amount would be payable as a single sum payment if one subsidiary corporation of a service recipient that consists of multiple corporations is sold, but as an installment payment if another subsidiary corporation of the same service recipient is sold, then the sale of the one subsidiary corporation is treated as a separate payment trigger from the sale of the other subsidiary corporation.

^N_W⁺_E (B) Certain payment triggers disregarded. The possibility that the following payment triggers will occur in

the future is disregarded for purposes of determining the total amount deferred (but not for purposes of determining whether the plan otherwise complies with the requirements of section 409A(a)):

^N_S ^W_E (1) A payment trigger that, if the trigger were the sole trigger determining when the amount would become payable, would cause the amount to be subject to a substantial risk of forfeiture, provided that if there is more than one payment trigger applicable to an amount that otherwise would be disregarded under this paragraph (b)(2)(vii)(B)(1), none of such payment triggers will be disregarded unless all such payment triggers, if applied in combination as the only payment triggers, would also cause the amount to be subject to a substantial risk of forfeiture.

^N_S ^W_E (2) An unforeseeable emergency (as defined in §1.409A-3(i)(3)).

^N_S ^W_E (viii) Treatment of amounts that may qualify as short-term deferrals. For purposes of calculating the total amount deferred for a taxable year, the right to a payment that, under the terms of the arrangement and the facts and circumstances as of the last day of the taxable year, may be a short-term deferral as defined under § 1.409A-1(b)(4), is not included in the total amount deferred. In addition, even if such amount is not paid by the end of the applicable 21/2 month period so that the amount is deferred compensation, the amount is not includible in the total amount deferred until the service provider's taxable year in which the applicable 21/2 month period expires.

^N_S ^W_E (ix) Examples. The following examples illustrate the provisions of paragraphs (b)(2)(vi) through (viii) of this section. For all of the examples, the service provider is an individual taxpayer who is an employee of the service recipient, the service provider has a calendar year taxable year, and the total amount deferred is being calculated for the taxable year ending December 31, 2010. In each case, the service provider is not entitled to earnings on the amount deferred. The examples read as follows:

Example (1). Employee D, who is employed by Employer Z, is entitled to commence receiving payments at age 65. The plan provides that Employee D will receive a single sum payment, except that, after Employee D attains age 62 but before Employee D attains age 64 (whether or not Employee D is then employed by Employer Z), Employee D can elect to receive payments as a single life annuity. Employee D is age 54 as of December 31, 2010. For purposes of determining the available times and forms of payment, Employee D is assumed to survive to age 62 and be eligible to elect a single life annuity. Accordingly, for purposes of determining the total amount deferred for 2010, the amount is treated as

payable as either a single sum payment or a single life annuity, whichever is more valuable.

Example (2). Employee E is entitled to a single life annuity commencing on January 1, 2020 if Employee E is not married as of January 1, 2020. Employee E is entitled to either a single life annuity or a subsidized joint and survivor annuity commencing on January 1, 2020 if Employee E is married as of January 1, 2020. Employee E is not married as of December 31, 2010. For purposes of determining the total amount deferred for 2010, Employee E is assumed to remain unmarried indefinitely, so that the subsidized joint and survivor annuity is not an available form of payment. Accordingly, for purposes of determining the total amount deferred for 2010, the amount is treated as payable as a single life annuity commencing January 1, 2020.

Example (3). Employee F is entitled to a series of three payments of \$1,000 due on January 1, 2020, January 1, 2021, and January 1, 2022. Under the plan's terms, Employer X has the discretion to accelerate one or more of the payments, provided that no payment may be made before January 1, 2020. Because there is no reduction in the amount payable if a payment is accelerated, an accelerated payment is more valuable than a payment made in accordance with the three-year schedule of payments. If Employee F does not have a legally binding right to a single sum payment on January 1, 2020 (or any other form of accelerated payment), then an accelerated payment is not an available time and form of payment and, for purposes of determining the total amount deferred for 2010, the amount is treated as payable as a series of three payments of \$1,000 on January 1, 2020, January 1, 2021, and January 1, 2022.

Example (4). The facts are the same as in Example 3, except that Employer X has no discretion to accelerate one or more of the payments. Rather, Employee F has the right to accelerate one or more of the payments provided that a payment may not be paid at any date before the later of January 1, 2020 or the date 12 months after the date of such election. As of December 31, 2010, the earliest date upon which Employee F may elect to have a payment made is January 1, 2020. Because there is no reduction in the amount payable if a payment is accelerated, the earliest possible date of payment is the most valuable time and form of payment. Accordingly, for purposes of determining the total amount deferred for 2010, the amount is treated as payable as a single sum payment of \$3,000 on January 1, 2020.

Example (5). Employee G is entitled to a single sum payment upon separation from service if Employee G separates from service before January 1, 2020 and a single life annuity if Employee G separates from service after December 31, 2019. As of December 31, 2010, Employee G has not separated from service. Under paragraph (b)(2)(vi)(A) of this section, the total amount deferred is determined based upon the amount that would be payable if Employee G separated from service on December 31, 2010. Accordingly, the single life annuity is not treated as an available

time and form of payment, so that the amount is treated as payable as a single sum payment upon separation from service.

Example (6). Employee H is entitled to a single sum payment of deferred compensation upon the earlier of January 1, 2020 or an unforeseeable emergency. Because the payment upon an unforeseeable emergency is disregarded, for purposes of determining the total amount deferred, the deferred amount is treated as payable only on January 1, 2020.

Example (7). Employee I is entitled to a single sum payment of deferred compensation upon the earlier of January 1, 2020 or Employee I's involuntary separation from service. Under the facts and circumstances existing at the time the right to the payment was granted, if the deferred amount had been payable only upon Employee I's involuntary separation from service, the amount would have been subject to a substantial risk of forfeiture. Under paragraph (b)(2)(iv)(B) of this section, the right to a payment upon the Employee I's involuntary separation from service is disregarded, and the amount is treated as payable only on January 1, 2020.

Example (8). Employee J is entitled to a single sum payment of deferred compensation upon the earlier of January 1, 2020 or Employee J's separation from service. As of December 31, 2010, Employee J has not separated from service. Under paragraph (b)(2)(vi)(A) of this section, the total amount deferred is determined based upon the amount that would be payable if Employee J separated from service on December 31, 2010 and therefore had the right to receive the payment on December 31, 2010. The total amount deferred for 2010 is the greater of the amount that would be payable on December 31, 2010 or the present value of the amount that would be payable on January 1, 2020.

Example (9). Employee K is entitled to a single sum payment of deferred compensation upon the earlier of January 1, 2020 or the first day of the third month following Employee K's separation from service. As of December 31, 2010, Employee K has not separated from service. Under paragraph (b)(2)(vi)(A) of this section, the total amount deferred is determined based upon the amount that would be payable if Employee K separated from service on December 31, 2010, and therefore had a right to a payment on March 1, 2011. The total amount deferred for 2010 is the greater of the present value as of December 31, 2010 of the amount that would be payable on March 1, 2011 or the present value as of December 31, 2010 of the amount that would be payable on January 1, 2020.

Example (10). Employee L is entitled to a single sum payment of deferred compensation upon the earlier of January 1, 2020 or a separation from service that occurs on or before July 1, 2010. As of December 31, 2010, Employee L has not separated from service. For purposes of determining the total amount deferred, the right to be paid upon a separation from service on or before

July 1, 2010 is ignored because it is no longer a possible payment trigger, and the amount is treated as payable only on January 1, 2020.

Example (11). Employee M is entitled to a single sum payment of deferred compensation upon the earliest of the date Employee M dies, Employee M attains age 65, or a child of Employee M becomes a full-time student at an accredited college or university (whether or not Employee M continues to be employed on such date). As of December 31, 2010, Employee M has a 10-year-old child who is in the fifth grade. For purposes of determining the total amount deferred, the earliest time that the payment reasonably could be due upon Employee M's child entering a college or university is August 1, 2018. Thus, the total amount deferred for 2010 is the more valuable of the amount that would be payable on the Employee M's 65th birthday and the amount that would be payable on August 1, 2018. Because any additional value that would be payable upon Employee M's death is a death benefit excluded from the definition of deferred compensation under section 409A(d)(1)(B) and §1.409A-1(a)(5), that additional value, if any, is not required to be calculated.

^N₅ (3) *Account balance plans.*

^N₅ (i) In general. For purposes of this section, if benefits are provided under a nonqualified deferred compensation plan that is described in §1.409A-1(c)(2)(i)(A) or (B) (an account balance plan), the present value of the amount payable equals the amount credited to the service provider's account as of the last day of the taxable year, including both the principal amount credited to the account, and any earnings or losses attributable to the principal amounts credited to the account through the last day of the taxable year. For purposes of this section, earnings or losses means any increase or decrease in the amount credited to a service provider's account that is attributable to amounts previously credited to the service provider's account, regardless of whether the plan denominates that increase or decrease as earnings or losses. For rules related to the crediting of earnings, see paragraph (b)(2)(iii) of this section. For rules relating to earnings based on an unreasonable interest rate or a rate of return based on an investment other than a single predetermined actual investment or a single reasonable interest rate, see paragraph (b)(3)(ii) of this section.

^N₅ (ii) Unreasonable rate of return.

^N₅ (A) Application. This paragraph (b)(3)(ii) applies to an account balance plan under which the amount of earnings or losses credited is not based on either a predetermined actual investment, within the meaning of §31.3121(v)(2)-1(d)(2)(i)(B) of this chapter, or a rate of interest that is not higher than a reasonable rate of interest, within the

meaning of § 31.3121(v)(2)-1(d)(2)(i)(C) of this chapter, as determined by the Commissioner.

^N_S ^W_E (B) Unreasonably high interest rate. If the earnings or losses to be credited under a plan are based on an unreasonably high rate of interest, the amount deferred under the plan is equal to the present value as of the end of the taxable year (using a reasonable interest rate) of the amount that will be credited to the service recipient's account using the unreasonably high rate for the entire period for which the unreasonably high interest will be credited under the plan, beginning with the last day of such taxable year and ending with the date the unreasonably high interest will no longer be credited (determined in accordance with the payment timing assumptions set forth in paragraph (b)(2)(vi) and (vii) of this section). If the service recipient fails to use a reasonable interest rate to determine the amount includible in income, AFR will be used. For purposes of this section, AFR means the appropriate applicable Federal rate (as defined pursuant to section 1274(d)) based on annual compounding, for the last month of the taxable year for which the amount includible in income is being determined. The period described in the first sentence of this paragraph (b)(3)(ii)(B) is used to determine the appropriate AFR (short-term, mid-term, or long-term). For purposes of this paragraph (b)(3)(ii)(B), an unreasonably high interest rate includes a fixed interest rate that exceeds an interest rate that is reasonable, within the meaning of §31.3121(v)(2)-1(d)(2)(i)(C) of this chapter.

^N_S ^W_E (C) Other rates of return. If the amount of earnings or losses credited is based on a rate of return that is not an unreasonably high interest rate, within the meaning of paragraph (b)(3)(ii)(B) of this section, but is also not a predetermined actual investment, within the meaning of §31.3121(v)(2)-1(d)(2)(i)(B) of this chapter or a rate of interest that is no more than a reasonable rate of interest, within the meaning of §31.3121(v)(2)-1(d)(2)(i)(C) of this chapter, the amount payable is a formula amount.

^N_S ^W_E (4) *Reimbursement and in-kind benefit arrangements.* For purposes of this section, if benefits for a service provider are provided under a nonqualified deferred compensation plan described in §1.409A-1(c)(2)(i)(E) (a reimbursement arrangement), or under a nonqualified deferred compensation plan that would be described in §1.409A-1(c)(2)(i)(E) except that the amounts, separately or in the aggregate, 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, the arrangement is treated as providing for a formula amount to the extent that the expenses to be reimbursed are not explicitly identified to be a specific amount. Notwithstanding the foregoing, if the expenses eligible for reimbursement are limited, it is presumed that the limit reflects the

reasonable amount of eligible expenses that the service provider will incur at the earliest possible date during the time period to which the limit applies, and for which the service provider will request reimbursement at the earliest possible date that the service provider may request reimbursement. This presumption may be rebutted only by demonstrating by clear and convincing evidence that it is unreasonable to assume that a service provider would incur such amount of expenses during the applicable time period. This presumption is not applicable to any reimbursement arrangement to which §1.409A-3(i)(1)(iv)(B) applies (certain medical reimbursement arrangements). In addition, this paragraph (b)(4) also applies to an arrangement providing a service provider a right 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.

^N_W^E_S (5) *Split-dollar life insurance arrangements.* For purposes of this section, if benefits for a service provider are provided under a nonqualified deferred compensation plan described in §1.409A-1(c)(2)(i)(F) (a split-dollar life insurance arrangement), the amount of the future payment to which the service provider is entitled is treated as the amount that would be includible in income under § 1.61-22 or §1.7872-15 (as applicable) or, if those regulations are not applicable, the amount that would be includible in income under any other applicable guidance. For this purpose, the payment timing assumptions set forth in paragraph (b)(2)(vi) and (vii) of this section generally apply. However, in the case of an arrangement subject to §1.7872-15, to the extent the assumptions set forth in paragraph (b)(2)(vi) and (vii) of this section conflict with the provisions of §1.7872-15, the provisions of §1.7872-15 apply, and the conflicting assumptions set forth in paragraph (b)(2)(vi) and (vii) of this section do not apply. In either case, for purposes of determining the total amount deferred under the plan for the taxable year, the benefits under the split-dollar life insurance arrangement are included only to the extent that the right to such benefits constitutes a right to deferred compensation under §1.409A-1(b).

^N_W^E_S (6) *Stock rights.* If a stock right has not been exercised during the service recipient's taxable year, and remains outstanding as of the last day of the service provider's taxable year for which the total amount deferred is being calculated, the total amount deferred under the stock right for such taxable year is the excess of the fair market value of the underlying stock on the last day of the service provider's taxable year (determined in accordance with §1.409A-1(b)(5)(iv)) over the sum of the stock right's exercise price plus any amount paid for the stock right. If a stock right has been exercised during the service provider's taxable year, the payment amount for purposes of calculating the total amount deferred for the taxable year under the stock right is the excess of the fair market value of the underlying stock (as determined in accordance with §1.409A-1(b)(5)(iv)) on the date of exercise over the sum of the exercise price of the stock right and any amount paid for the stock right.

^N_W^E_S (7) *Anti-abuse provision.* The Commissioner may disregard all or part of the rules of paragraphs (b)(2) through (b)(6) of this section or all or part of the plan's terms if the Commissioner determines based on all of the facts and circumstances that the plan terms have been established to

eliminate or minimize the total amount deferred under the plan determined in accordance with the rules of paragraphs (b)(2) through (b)(6) of this section and if the rules of paragraphs (b)(2) through (b)(6) of this section were applied or such plan terms were given effect, the total amount deferred would not reasonably reflect the present value of the right. For example, if a plan provides that a deferred amount is payable upon a separation from service but also contains a provision that the amount will be forfeited upon a separation from service occurring on the last day of the service provider's taxable year (so that the application of paragraph (b)(2)(vii)(A) of this section treating the service provider as separating from service on the last day of the taxable year for purposes of determining the timing of the payment in calculating the total amount deferred would result in a zero amount deferred), the latter provision will be disregarded.

^N_SW+E (c) Additional 20 percent tax under section 409A(a)(1)(B)(i)(II). With respect to an amount required to be included in income under section 409A(a) for a taxable year, the amount is subject to an additional income tax equal to 20 percent of the amount required to be included in income under section 409A(a).

^N_SW+E (d) Premium interest tax under section 409A(a)(1)(B)(i)(I).

^N_SW+E (1) *In general.* With respect to an amount required to be included in income under section 409A(a) for a taxable year, the amount is subject to an additional income tax equal to the amount of interest at the underpayment rate plus one percentage point on the underpayments that would have occurred had the deferred compensation been includible in the service provider's gross income for the taxable year in which first deferred or, if later, the first taxable year in which such deferred compensation is not subject to a substantial risk of forfeiture. The amount required to be allocated to determine the additional tax described in this paragraph (d) is the amount required to be included in income under section 409A(a) for the taxable year, regardless of whether additional amounts were deferred under the plan in previous years.

^N_SW+E (2) *Identification of taxable year deferred amount was first deferred or vested.*

^N_SW+E (i) Method of identification. The following method is applied for purposes of determining the taxable year or years in which an amount required to be included in income under section 409A(a) was first deferred and not subject to a substantial risk of forfeiture.

^N_SW+E (A) For each taxable year preceding the taxable year for which the deferred amount is includible in income (the current taxable year) in which the service provider had an amount deferred under the plan that was not subject to a substantial risk of forfeiture (vested), ending with the later of the first taxable year in which the service provider had no vested amount deferred or the first taxable year beginning after December 31, 2004, calculate the vested total amount deferred for such year. For each year, include

any deferred amount that was previously included in income under paragraph (a)(3) of this section but has not been paid, but exclude any amount paid to (or on behalf of) the service provider during such taxable year.

$\frac{N}{S}$ (B) Identify any payments made under the plan to (or on behalf of) the service provider for each taxable year identified in paragraph (d)(2)(i)(A) of this section.

$\frac{N}{S}$ (C) Identify any deemed net investment losses or other net decreases in the amount deferred (other than as a result of a payment) applicable to amounts that are vested for the current taxable year and each preceding taxable year identified in paragraph (d)(2)(i)(A) of this section.

$\frac{N}{S}$ (D) Starting with the first taxable year during which there was a payment identified under paragraph (d)(2)(i)(B) of this section or a loss identified under paragraph (d)(2)(i)(C) of this section (or both), subtract the total payments and loss for such taxable year from the amount determined under paragraph (d)(2)(i)(A) of this section for the earliest taxable year before such year in which there is such an amount, and from the amount determined under paragraph (d)(2)(i)(A) of this section for each subsequent taxable year ending before the taxable year in which the payment was made or the loss incurred. Do not reduce any taxable year-end balance below zero.

$\frac{N}{S}$ (E) Repeat this process for each subsequent taxable year during which there was a payment identified under paragraph (d)(2)(i)(B) of this section or a loss identified under paragraph (d)(2)(i)(C) of this section (or both).

$\frac{N}{S}$ (F) For each taxable year identified in paragraph (d)(2)(i)(A) of this section, determine the excess (if any) of the remaining amount deferred for the taxable year over the remaining amount deferred for the previous taxable year. Treat the amount deferred in taxable years beginning before January 1, 2005 as zero.

$\frac{N}{S}$ (G) Determine how much of the total amount deferred for the current taxable year was previously included in income in accordance with paragraph (a)(3) of this section.

$\frac{N}{S}$ (H) Subtract the amount determined in paragraph (d)(2)(i)(G) of this section from the excess amount determined in paragraph (d)(2)(i)(F) of this section for the earliest taxable year in which there is any such excess amount, but do not reduce the balance below zero. If the amount determined in paragraph (d)(2)(i)(G) of this section exceeds the amount determined in paragraph

(d)(2)(i)(F) of this section for that earliest taxable year, subtract the excess from the amount determined in paragraph (d)(2)(i)(F) of this section for the next succeeding taxable year, but do not reduce the balance below zero. Repeat this process until the excess has been reduced to zero. The balance remaining with respect to each taxable year identified in paragraph (d)(2)(i)(A) of this section is the portion of the amount includible in income under section 409A(a) in the current taxable year that was first deferred and vested in that taxable year.

^N_W⁺_S^E (ii) Examples. The following examples illustrate the provisions of paragraph (d)(2) of this section. In all of the following examples, the service provider is an individual taxpayer with a calendar year taxable year who elects to defer a portion of the bonus that would otherwise be payable to the service provider in each of Year 1 through Year 4. All amounts deferred are deferred under the same plan, and no amount deferred under the plan is ever subject to a substantial risk of forfeiture. The plan does not fail to meet the requirements of section 409A(a) in any year prior to Year 4, and no amounts deferred under the plan are otherwise includible in income until Year 4, except for payments actually made to the service provider. The service provider had no amount deferred under the plan prior to Year 1. The plan fails to meet the requirements of section 409A(a) in Year 4. The examples read as follows:

Example (1).

	Year 2	Year 3	Year 4	Year 1	Year
Opening Total Amount				0	
110	275	495			
Bonus Deferral				100	
150	200	250			
Net Gains (Losses)				10	
15	20	25			
Payments				0	
0	0	0			
Closing Total Amount				110	
275	495	770			

(i) The amount required to be included in income under section 409A is 770. To calculate the premium interest tax, the 770 must be allocated to the year or years in which the amount was first deferred and vested.

(ii) Step A. Identification of vested total amount deferred excluding payments and including deferred amounts previously included in income.

	Year 1	Year 2
Year 3		
495	110	275

(iii) Step B. Identification of any payments for each year other than Year 4.

	Year 1	Year 2
Year 3		
0	0	0

(iv) Step C. Identification of any other decreases attributable to vested amounts.

	Year 1	Year 2	Year 3
Year 4			
0	0	0	0

(v) Steps D and E. Subtraction of payments and decreases from amounts deferred.

	Year 1	Year 2
Year 3		
495	110	275

-0	-0	-0
-----	-----	-----
495	110	275
-----	-----	-----

(vi) Step F. Subtraction of previous year total from each year's total.

Year 3	Year 1	Year 2
-----	-----	-----
495	110	275
-275	-0	-110
-----	-----	-----
220	110	165
-----	-----	-----

(vii) Because no amount was previously included in income, Step G does not apply. Accordingly, the 770 is allocated such that 110 is treated as first deferred and vested in Year 1, 165 in Year 2, 220 in Year 3. The remainder (275) is treated as first deferred in Year 4, but is not required to be allocated for purposes of the premium interest tax because there is no hypothetical underpayment for such year.

Example (2).

2	Year 3	Year 4	Year 1	Year
-----	-----	-----	-----	-----
Opening Total Amount	110	235	365	0
Bonus Deferral	150	200	250	100
Net Gains (Losses)	(25)	(30)	25	10
Payments	0	(40)	(50)	0
Closing Total Amount	235	365	590	110
-----	-----	-----	-----	-----

 (i) The amount that is includible in income under section 409A(a) for Year 4 is the closing total amount (590), plus the amounts paid during Year 4 that were includible in income (50) or 640. To calculate the premium interest tax, the 640 must be allocated to the year or years in which the amount was first deferred and vested.

(ii) Step A. Identification of vested total amount deferred excluding payments and including deferred amounts previously included in income.

	Year 1	Year 2
Year 3		
-----	-----	-----
365	110	235

(iii) Step B. Identification of any payments for each year other than Year 4.

	Year 1	Year 2
Year 3		
-----	-----	-----
(40)	0	0

(iv) Step C. Identification of any other decreases attributable to vested amounts.

	Year 1	Year 2	Year 3
Year 4			
-----	-----	-----	-----
0	0	(25)	(30)

(v) Steps D and E. Subtraction of payments and decreases from amounts deferred.

	Year 1	Year 2
Year 3		
	110	235
365		
	-25 (Year 2)	-40 (Year 3)
	-40 (Year 3)	-30 (Year 3)
	-30 (Year 3)	
	15	165
365		

(vi) Step F. Subtraction of previous year total from each year's total.

	Year 1	Year 2
Year 3		
	15	165
365		
	-0	-15
-165		
	15	150
200		

(vii) Because no amount was previously included in income, Step G does not apply. Accordingly, the 640 is allocated such that 15 is treated as first deferred and vested in Year 1, 150 in Year 2, and 200 in Year 3. The remaining amount includible in income under section 409A for Year 4 (275) is treated as first deferred in Year 4, but is not required to be allocated for purposes of the premium interest tax because there is no hypothetical underpayment for Year 4.

Example (3).

(i) The facts are the same as in Example 2 except 125 was previously included in income under paragraph (a)(3) of this section. Accordingly, of the 590 closing total amount for Year 4

plus the 50 payment during Year 4, or 640, only 515 (640 - 125) must be included in income under section 409A(a). To calculate the premium interest tax, the 125 must be allocated to the year or years in which such amount was first deferred.

(ii) Step G. Allocation of amounts previously included in income.

	Year 1	Year 2
Year 3		
200	15	150
-0	-15	-110
200	0	40

(iii) Accordingly, for purposes of calculating the premium interest tax, the 125 previously included in income is allocated so that of the 515 includible in income under section 409A(a), 0 is treated as first deferred and vested in Year 1, 40 in Year 2, and 200 in Year 3.

^N_S^E (3) *Calculation of hypothetical underpayment for the taxable year during which a deferred amount was first deferred and vested.*

^N_S^E (i) Calculation method. The hypothetical underpayment for a taxable year is determined by treating as an additional cash payment of compensation to the service provider for such taxable year, the amount determined pursuant to paragraph (d)(2) of this section to be the portion of the amount includible in income under section 409A(a) that was first deferred and vested during such taxable year. The hypothetical underpayment is calculated based on the service provider's taxable income, credits, filing status, and other tax information for the year, based on the service provider's original return filed for such year, as adjusted by any examination for such year or any amended return the service provider filed for such year that was accepted by the Commissioner. The hypothetical underpayment must reflect the effect that such additional compensation would have had on the service provider's Federal income tax liability for such year, including the continued availability of any deductions taken, and the use of any carryovers such as carryover losses. For purposes of calculating a hypothetical underpayment in a subsequent year (whether or not a portion of the amount includible in income under section 409A(a) was first deferred and vested in the subsequent year), any changes to the service provider's Federal income tax liability for the subsequent

year that would have occurred if the portion of the amount that was first deferred and vested during the previous taxable year had been included in the service provider's income for the previous year must be taken into account. Assumptions not based on the service provider's taxable income, credits, filing status, and other tax information for the year, based on the service provider's original return for such year, as adjusted by any examination for such year or any amended return the service provider filed for such year that was accepted by the Commissioner, may not be applied. For example, the service provider may not assume that some of the additional compensation would have been deferred under the terms of a qualified plan. If the service provider's Federal income tax liability for the taxable year in which an amount required to be included in income under section 409A(a) was first deferred and vested is adjusted (for example, by an amended return or IRS examination), and the adjustment affects the amount of the hypothetical underpayment, the service provider must recalculate the hypothetical underpayment and adjust the amount of premium interest tax due with respect to such inclusion in income under section 409A(a), as appropriate.

^N₅ (ii) Examples. The following examples illustrate the provisions of paragraph (d)(3)(i) of this section. In all of the following examples, Employee N is an individual taxpayer with a calendar year taxable year. For the year 2020, Employee N has a total amount deferred of \$100,000 which is includible in income under section 409A(a). For purposes of determining the premium interest tax, assume that \$30,000 was first deferred and vested in 2018, \$35,000 was first deferred and vested in 2019, and \$35,000 was first deferred and vested in 2020. The first year that Employee N had a vested deferred amount under the plan was 2018. The examples read as follows:

Example (1). For the taxable years 2018 and 2019, Employee N has no carryover losses or other items a change in which could affect the adjusted gross income for a subsequent taxable year. Employee N determines the hypothetical underpayment for 2018 by assuming an additional cash compensation payment of \$30,000 for 2018, and determining the hypothetical underpayment of Federal income tax that would result. Employee N determines the hypothetical underpayment for 2019 by assuming an additional cash compensation payment of \$35,000 in 2019, and determining the hypothetical underpayment of Federal income tax for 2019 that would result. There is no hypothetical underpayment with respect to hypothetical income in 2020 because the tax payment would not have been due until 2021. Therefore, Employee N is not required to determine a hypothetical underpayment for 2020.

Example (2). The facts are the same as in Example 1, except that in 2018, Employee N had an excess charitable contribution the deduction of which was not permitted under section 170(b), and which was carried over to subsequent taxable years under section 170(d). For purposes of determining the hypothetical underpayment for 2018, Employee N uses the charitable contribution deduction that otherwise would have been available if

the \$30,000 compensation payment had actually been made. Employee N must then calculate the hypothetical underpayment for all subsequent years in a manner that eliminates the portion of any carryovers of excess contributions under section 170(d) related to the charitable contribution in 2018 that would not have been available in such subsequent years as a result of having been deducted in 2018.

Example (3). The facts are the same as in Example 2, except that in 2021 the IRS examines Employee N's 2018 return and determines that Employee N had \$20,000 in unreported income for that year. In addition to paying the tax deficiency owed for 2018, Employee N must redetermine the hypothetical underpayment for 2018 and recalculate the premium interest tax owed for 2020.

^N_S (4) *Calculation of hypothetical premium underpayment interest.*

^N_S (i) Calculation method. The amount of hypothetical premium underpayment interest is determined for any taxable year by applying the applicable rate of interest under section 6621 plus one percentage point to determine the underpayment interest under section 6601 that would be due for such underpayment as of the last day of the taxable year for which the amount deferred is includible in income under section 409A(a). The amount of additional income tax under paragraph (d)(2) of this section with respect to an amount required to be included in income under section 409A(a) is the sum of all of the hypothetical premium underpayment interest for all years in which there was determined a hypothetical underpayment.

^N_S (ii) Examples. The following examples illustrate the provisions of this paragraph (d)(4). In each of these examples, the service provider is an individual taxpayer with a calendar year taxable year. At all times the total amount deferred under the nonqualified deferred compensation plan is not subject to a substantial risk of forfeiture. The examples read as follows:

Example (1). Employee O has a total amount deferred under a nonqualified deferred compensation plan for 2010 of \$100,000. The entire deferred amount was first deferred in 2006. For purposes of calculating the hypothetical premium underpayment interest tax, Employee O first must determine the hypothetical underpayment for taxable years 2006 through 2009 under the rules of paragraph (d)(3) of this section. Then Employee O must determine the underpayment interest under section 6601 that would have accrued, calculated using the applicable underpayment interest rate under section 6621 increased by one percentage point, applied through December 31, 2010. That amount is the premium interest tax that is due for 2010.

Example (2). Employee P has a total amount deferred under a nonqualified deferred compensation plan for 2010 of \$100,000. \$60,000 of that deferred amount was first deferred in 2006.

\$30,000 of that amount was first deferred in 2008. \$10,000 of that amount was first deferred in 2010. For purposes of calculating the hypothetical premium underpayment interest tax, Employee P first must determine the hypothetical underpayment for taxable years 2006 through 2009 under the rules of paragraph (d)(3) of this section applying \$60,000 of hypothetical additional compensation for 2006, and applying \$30,000 of hypothetical additional compensation for 2008. The \$10,000 of hypothetical additional compensation in 2010 would not result in a hypothetical underpayment because the Federal income tax applicable to that hypothetical additional compensation would not yet be due. Second, Employee P must determine the underpayment interest under section 6601 that would have accrued, calculated using the applicable underpayment interest rate under section 6621 increased by one percentage point, applied through December 31, 2010, for both the hypothetical underpayment occurring in 2006 and the hypothetical underpayment occurring in 2008. The sum of those two amounts is the premium interest tax that is due for 2010.

^N_W⁺_SE (e) Amounts includible in income under section 409A(b) [Reserved].

^N_W⁺_SE (f) Application of amounts included in income under section 409A to payments of amounts deferred.

^N_W⁺_SE (1) *In general.* Section 409A(c) provides that any amount included in gross income under section 409A is not required to be included in gross income under any other provision of this chapter or any other rule of law later than the time provided in this section. An amount included in income under section 409A that has neither been paid in the taxable year the amount was included in income under section 409A nor served as the basis for a deduction under paragraph (g) of this section is allocated to the first payment of an amount deferred under the plan in any year subsequent to the year the amount was included in income under section 409A. To the extent the amount included in income under section 409A exceeds such payment, the excess is allocated to the next payment of an amount deferred under the plan. This process is repeated until the entire amount included in income under section 409A has been paid or the service provider has become entitled to a deduction under paragraph (g) of this section.

^N_W⁺_SE (2) *Application of the plan aggregation rules.* The plan aggregation rules of §1.409A-1(c)(2) apply to the allocation of amounts previously included in income under section 409A to payments made under the plan. Accordingly, references to an amount deferred under a plan, or a payment of an amount deferred under a plan, refer to an amount deferred or a payment made under all arrangements in which a service provider participates that together are treated as a single plan under §1.409A-1(c)(2).


^N_W⁺_SE (3) *Examples.* The following examples illustrate the provisions of this section. In each of these examples, the service provider is an individual taxpayer with a calendar year taxable year. Each service provider has a

total amount deferred under a nonqualified deferred compensation plan of \$0 for 2010, a total amount deferred under the plan of \$100,000 for 2011, a total amount deferred under the plan of \$250,000 for 2012, and a total amount deferred under the plan of \$400,000 for 2013. At all times the total amount deferred under the plan is not subject to a substantial risk of forfeiture. During 2011, the plan fails to comply with section 409A(a) and each service provider includes \$100,000 in income under section 409A. Except as otherwise provided in the following examples, the service provider does not receive any payments of amounts deferred under the plan. The examples read as follows:

Example (1). During 2012, Employee Q receives a \$10,000 payment under the plan. During 2013, Employee Q receives a \$150,000 payment under the plan. For 2012, \$10,000 of the \$100,000 included in income under section 409A(a) is allocated under paragraph (f)(1) of this section to the \$10,000 payment, so that no amount is includible in gross income as a result of such payment and Employee Q retains \$90,000 of amounts previously included in income under the plan to allocate to future plan payments. For 2013, the remaining \$90,000 included in income under section 409A(a) is allocated to the \$150,000 payment, so that only \$60,000 is includible in income as a result of such payment.

Example (2). During 2012, Employee R receives a \$10,000 payment under the plan. During 2014, Employee R receives a \$50,000 payment, equaling the entire amount deferred under the plan. For 2012, \$10,000 of the \$100,000 previously included in income is allocated pursuant to paragraph (f)(1) of this section to the \$10,000 payment, so that no amount is includible in gross income as a result of such payment. For 2014, \$50,000 of the \$90,000 remaining amount previously included in income is allocated pursuant to paragraph (f)(1) of this section to the \$50,000 payment, so that no amount is includible in gross income as a result of such payment. Provided that the requirements of paragraph (g) of this section are otherwise met, Employee R is entitled to a deduction for 2014 equal to the remaining amount (\$40,000) that was previously included in income under section 409A(a) that has not been allocated to a payment under the plan.

 **(g) Forfeiture or other permanent loss of right to deferred compensation.**

 *(1) Availability of deduction to the service provider.* If a service provider has included a deferred amount in income under section 409A, but has not actually received payment of such deferred amount or otherwise allocated the amount included in income under paragraph (f) of this section, the service provider is entitled to a deduction for the taxable year in which the right to that amount of deferred compensation is permanently forfeited under the plan's terms or the right to the payment of the amount is otherwise permanently lost. The deduction to which the service provider is entitled equals the deferred amount included in income under section 409A in a previous year, less any portion of such deferred amount previously included in income under section 409A that was allocated under paragraph (f) of this section to amounts paid under the plan, including any deferred amount paid in the year the right to any remaining deferred compensation is permanently forfeited or otherwise

lost. For this purpose, a mere diminution in the deferred amount under the plan due to deemed investment loss, actuarial reduction, or other decrease in the amount deferred is not treated as a permanent forfeiture or loss of the right if the service provider retains the right to an amount deferred under the plan (whether or not such right is subject to a substantial risk of forfeiture as defined in §1.409A-1(d)). In addition, a deferred amount is not treated as permanently forfeited or otherwise lost if the obligation to make the payment of such deferred amount is substituted for another deferred amount or obligation to make a payment in a future year. However, a deferred amount is treated as permanently lost if the service provider's right to receive the payment of the deferred amount becomes wholly worthless during the taxable year. Whether the right to the payment of a deferred amount has become wholly worthless is determined based on all the facts and circumstances existing as of the last day of the relevant service provider taxable year.

^N_W^E_S (2) *Application of the plan aggregation rules.* For purposes of determining whether the right to a deferred amount is permanently forfeited or otherwise lost, the plan aggregation rules of § 1.409A-1(c) apply. Accordingly, if the right to an identified deferred amount under a plan is permanently forfeited or otherwise lost, but an additional amount remains deferred under the plan, the service provider is not entitled to a deduction.


^N_W^E_S (3) *Examples.* The following examples illustrate the provisions of this paragraph (g). In each example, the service provider is an individual taxpayer who has a calendar year taxable year and the service recipient does not experience bankruptcy at any time or otherwise discharge any obligation to make a payment of a deferred amount, except as expressly provided in the example. The examples read as follows:

Example (1). For 2010, Employee S has a total amount deferred under an elective account balance plan of \$1,000,000. The plan fails to meet the requirements of section 409A(a) during 2010 and Employee S includes \$1,000,000 in income under section 409A(a) for the year 2010. In 2011, Employee S experiences investment losses but no payments before July 1, 2011, such that Employee S's account balance under the plan is \$500,000. On July 1, 2011, Employee S separates from service and receives a \$500,000 payment equal to the entire amount deferred under the plan, and retains no other right to deferred compensation under the plan (including all arrangements aggregated with the arrangement under which the payment was made). For 2011, Employee S is entitled to deduct \$500,000 (which is the amount Employee S previously included in income under section 409A(a) (\$1,000,000) less the amount actually received by Employee S (\$500,000)).

Example (2). For 2010, Employee T has a total amount deferred under an elective account balance plan of \$1,000,000. The plan fails to meet the requirements of section 409A(a) for 2010 and Employee T includes \$1,000,000 in income under section 409A(a) for 2010. For 2011, Employee T has a total amount deferred under the plan of \$500,000, due solely to the deemed investment losses attributable to Employee T's account balance (with no payments being made during 2011). Because Employee T retains the right to an amount deferred under the plan,

Employee T is not entitled to a deduction for 2011 as a result of the deemed investment losses.

Example (3). For 2010, Employee U has a total amount deferred under an elective account balance plan of \$1,000,000. The elective account balance plan consists of one arrangement providing for salary deferrals with an amount deferred for 2010 of \$600,000, and another arrangement providing for bonus deferrals with an amount deferred for 2010 of \$400,000. The plan fails to meet the requirements of section 409A(a) during 2010 and Employee U includes \$1,000,000 in income under section 409A(a) for 2010. On July 1, 2011, Employee U's account balance attributable to the salary deferral arrangement is \$500,000, the reduction of which is due solely to deemed investment losses in 2011 and not any payments. On July 1, 2011, Employee U is paid the \$500,000 equaling the entire account balance attributable to the salary deferral arrangement. On December 31, 2011, Employee U has an account balance attributable to the bonus deferral arrangement equal to \$300,000. Because Employee U retains an amount deferred under the elective account balance plan, Employee U is not entitled to a deduction for 2011 as a result of the deemed investment losses.

 **(h) Effective/applicability date.** The rules of this section apply to taxable years ending on or after the date of publication of the Treasury decision adopting these rules as final regulation in the Federal Register.