representation, right to make a statement and present documentary evidence, to request witnesses, to be present throughout the hearing, and advance advisement of inmate rights at the hearing, and as to making a record of the proceedings.

(c) Ordinarily, staff may place an inmate in administrative detention as provided in paragraph (a) of this rule relating to protection cases, for a period not to exceed 90 days. Staff shall clearly document in the record the reasons for any extension beyond this 90-day period.

(d) Where appropriate, staff shall first attempt to place the inmate in the general population of their particular facility. Where inappropriate, staff shall clearly document the reason(s) and refer the case, with all relevant material, to their Regional Director, who, upon review of the material, may order the transfer of a protection case.

Dated: August 24, 1987.

J. Michael Quinlan,

Director, Bureau of Prisons.

[FR Doc. 87-19687 Filed 8-26-87; 8:45 am]

BILLING CODE 4410-05-M

federal register

Thursday
August 27, 1987

Part V

Environmental Protection Agency

Superfund Program; Interim Guidance on Compliance With Applicable or Relevant and Appropriate Requirements; Notice of Guidance

ENVIRONMENTAL PROTECTION AGENCY

[FRL-3249-8]

Superfund Program; Interim Guidance on Compliance With Other Applicable or Relevant and Appropriate Requirements

AGENCY: Environmental Protection Agency.

ACTION: Notice of guidance.

SUMMARY: The Comprehensive Environmental Response, Compensation and Liability Act, as amended, 42 U.S.C. 9601 *et seq.*, provides that the President may undertake actions in response to releases or threats of releases of hazardous substances or pollutants or contaminants, as may be necessary to protect human health or the environment. Section 121 of CERCLA requires that, subject to specified exceptions, remedial actions be undertaken in compliance with applicable or relevent and appropriate environmental laws, both State and Federal. Tody, EPA is publishing interim guidance on the implementation of this requirement, and solicits public comment on the guidance. The guidance is intended to assist State and Federal decisionmakers in selecting response actions under CERCLA. The Agency wishes to emphasize that the guidance is not intended to be a regulation or rule. EPA intends in the near future to propose revisions to the National Contingency Plan (NCP), which will address the § 121 requirements, as well as other matters; comments on today's guidance will be considered prior to proposal of the revised NCP.

DATES: Coments on this notice may sent to the Agency no later than October 13, 1987.

ADDRESSES: Comments should be sent to Steve Smith at the headquarters of the United States Environmental Protection Agency, 401 M Street SW., Mail Stop WH–548D, Washington, DC 20460.

FOR FURTHER INFORMATION CONTACT: Steve Smith or Arthur B. Weissman, Office of Emergency and Remedial Response, Policy and Analysis Staff, 401 M Street SW., Mail Stop WH–548D, Washington, DC 20460, (202) 382–2182.

SUPPLEMENTARY INFORMATION: Printed below in its entirety is the Interim Guidance on Compliance with Applicable or Relevant and Appropriate Requirements. This guidance is not a rule or regulation, but is intended to assist Federal and Sate decisionmakers in selecting response actions under CERCLA. The guidance describes how Federal and State requirements are generally to be indentified and applied, and in particular defines "promulgated" for the purpose of determining eligible State requirements. One of the most important features of the guidance is the direction it provides in determining the appropriate cleanup levels for surface or ground water that can be used for drinking. The Agency suggests that in most situations encountered in CERCLA actions the Agency's drinking water standards, known as Maximum Contaminant Levels (MCLs), are appropriate as cleanup levels, since there are the safe levels Americans experience everyday at the tap. In special circumstances, such as where either multiple contaminants or multiple pathways of exposure present extraordinary risks, the Agency will consider setting more stringent cleanup levels, and may consider Maximum Contaminant Level Goals (MCLGs), among other things, in setting such levels. MCLGs are used in determining MCLs but are not intended as drinking water standards. MCLs are set as close as feasible to their respective MCLGs, and in fact MCLs for many chemicals are set at the indentical level as their respective MCLGs.

Title: Interim Guidance on Compliance With Applicable or Relevant and Appropriate Requirements.

Executive Summary: The guidance addresses the requirement in CERCLA as amended by the Superfund Amendments and Reauthorization Act of 1986, that remedial actions comply with applicable or relevant and appropriate requirements (ARARs) of Federal laws and more stringent, promulgated State laws. The guidance describes how requirements are generally to be identified and applied, and discusses specifically compliance with State requirements and certain surface water and groundwater standards. "Applicable" and "relevant and appropriate" are defined, and the three types of ARARs (chemical-, location-, and action-specific) are described. Guidance is given on how and at what points ARARs are to be used in the remedial process. Eligible State requirements are defined, with particular reference to "promulgated," and direction is given on evaluating siting laws and on using the waiver regarding consistency of application. Finally, the guidance discusses the use of water standards specified in the law (MCLGs, FWQC, ACLs), and describes the use MCLs as cleanup standards for surface water or groundwater that is or may be used for drinking.

Purpose

This document provides interim guidance on compliance with other Federal and State environmental laws in conducting CERCLA remedial actions. The guidance is intended to help define the nature, scope, and use of applicable or relevant and approprate requirements. The guidance is not intended to be comprehensive or exhaustive. The Agency is currently developing a guidance manual that provides detailed information on potential ARARs in the major Federal environmental statutes.

Background

Section 121(d) of CERCLA, as amended by the Superfund Amendments and Reauthorization Act of 1986 (SARA), requires that Fund-financed, enforcement, and Federal facility remedial actions comply with requirements or standards under Federal and State environmental laws. The requirements that must be complied with are those that are applicable or relevant and appropriate to the hazardous substances, pollutants, or contaminants at a site or to the circumstances of the release. Compliance is required at the completion of the remedial action for hazardous substances, pollutants, or contaminants that remain on-site. Any such requirements may be waived under six conditions provided that protection of human health and environment is still assured.

SARA essentially codified and expanded upon the Agency's Compliance Policy, which was included in the National Contingency Plan (revised November 20, 1985). The major difference between that policy and the new statutory requirement is that the latter includes more stringent, promulgated State environmental standards as potentially applicable or relevant and appropriate requirements, and Maximum Contaminant Level Goals and Federal Water Quality Criteria as potentially relevant and appropriate requirements.

General Guidance on Identifying and Using ARARs

This section defines what ARARs are, describes the different types of ARARs, and discusses how they are applied to the remedial process.

Definition of ARARs

A requirement under other environmental laws may be either "applicable" or "relevant and appropriate" to a remedial action, but not both. A two-tier test may be applied:

first, to determine whether a given requirement is applicable; then, if it is not applicable, to determine whether it is nevertheless relevant and appropriate.

"Applicable requirements" means those cleanup standards, standards of control, and other substantive environmental protection requirements, criteria, or limitations promulgated under Federal or State law that specifically address a hazardous substance, pollutant, contaminant, remedial action, location, or other circumstance at a CERCLA site.

"Applicability" implies that the remedial action or the circumstances at the site satisfy all of the jurisdictional prerequisites of a requirement. For example, the minimum technology requirement for landfills under RCRA would apply if a new hazardous waste landfill unit (or an expansion of an existing unit) were to be built on a CERCLA site.

"Relevant and appropriate requirements" means those cleanup standards, standards of control, and other substantive environmental protection requirements, criteria, or limitations promulgated under Federal or State law that, while not "applicable" to a hazardous substance, pollutant, contaminant, remedial action, location, or other circumstance at a CERCLA site, address problems or situations sufficiently similar to those encountered at the CERCLA site that their use is well suited to the particular site.

The relevance and appropriateness of a requirement can be judged by comparing a number of factors, including the characteristics of the remedial action, the hazardous substances in question, or the physical circumstances of the site, with those addressed in the requirement. It is also helpful to look at the objective and origin of the requirement. For example, while RCRA regulations are not applicable to closing undisturbed hazardous waste in place, the RCRA regulation for closure by capping may be deemed relevant and appropriate.

A requirement that is judged to be relevant and appropriate must be complied with to the same degree as if it were applicable. However, there is more discretion in this determination: it is possible for only part of a requirement to be considered relevant and appropriate, the rest being dismissed if judged not to be relevant and appropriate in a given case.

Non-promulgated advisories or guidance documents issued by Federal or State governments do not have the status of potential ARARs. However, as described below, they may be considered in determined the necessary level of cleanup for protection of health or environment.

Types of ARARs

There are several different types of requirements that Superfund actions may have to comply with. The classification of ARARs below if offfered for illustrative purposes.

- Ambient or chemical-specific requirements set health or risk-based concentration limits or ranges in various environmental media for specific hazardous substances, pollutants, or contaminants. Examples: Maximum Contaminant Levels, National Ambient Air Quality Standards.

These requirements may set protective cleanup levels for the chemicals of concern in the designated media, or else indicate an acceptable level of discharge (e.g., air emission or wastewater discharge taking into account water quality standard) where one occurs in a remedial activity. If a chemical has more than one such requirement, the more stringent ARAR should be complied with.

There are at presents a limited number of actual ambient or chemical-specific requirements. In order to achieve remedies that are protective of health and environment, it may frequently be necessary to use chemical-specific advisory levels such as Carcinogenic Potency Factors or Reference Doses. While not actually ARARs, these chemical-specific advisory levels may factor significantly into the establishment of protective cleanup levels. Guidance for establishing such chemical-specific, health-based cleanup levels is given in the Superfund Public Health Evaluation Manual (EPA 540/1–86/060, Oct. 1986).

- Performance, design, or other action-specific requirements set controls or restrictions on particular kinds of activities related to management of hazardous substances, pollutants, or contaminants. Examples: RCRA regulations for closure of hazardous waste storage or disposal units; RCRA incineration standards; Clean Water Act pretreatment standards for discharges to POTWs.

These requirements are triggered not by the specific chemicals present at a site but rather by the particular remedial activities that are selected to accomplish a remedy. Since there are usually several alternative actions for any remedial site, very different requirements can come into play. These action-specific requirements may specify particular performance levels, actions, or technologies, as well as specific levels (or a methodology for setting specific levels) for discharged or residual chemicals.

- Locational requirements set restrictions on activities depending on the characteristics of a site or its immediate environs. Examples: Federal and State siting laws for hazardous waste facilities; sites on National Register of Historic Places.

These requirements function like action-specific requirements. Alternative remedial actions may be restricted or precluded depending on the location or characteristics of the site and the requirements that apply to it.

Using ARARs

This section explains how and where requirements may be applied in the remedial planning process.

First, actual ARARs can be identified only on a site-specific basis. They depend on the specific chemicals at a site, the particular actions proposed as a remedy, and the site characteristics. Guidance is being developed on the potential ARARs under the major Federal environmental statutes for various activities, locations, and chemicals.

Where there are no specific ARARs for a chemical or situation, or where such ARARs are not sufficient to be protective, one should identify pertinent health advisory levels (such as Reference Doses or Carcinogenic Potency Factors) as described above in order to ensure that a remedy is protective.

The different ARARs that may apply to a site and its remedial action should be identified and considered at multiple points in the remedial planning process, namely:

—During scoping of the RI/FS, chemical/specific and location-specific ARARs may be identified on a preliminary basis.

—During the site characterization phase of the Remedial Investigation, when the public health evaluation is conducted to assess risks at a site, the chemical-specific ARARs and advisories and location-specific ARARs are identified more comprehensively and used to help determine the cleanup goals.

—During development of remedial alternatives in the Feasibility Study, action-specific ARARs are identified for each of the proposed alternatives and considered along with other ARARs and advisories.

—During detailed analysis of alternatives all the ARARs and advisories for each alternative are examined as a package to determine

what is needed to comply with other laws and be protective.

—When an alternative is selected it must be able to attain all ARARs unless one of the six statutory waivers is invoked.

—During remedial design the technical specifications of construction must ensure attainment of ARARs.

Note that CERCLA § 121(e) exempts any on-site response action from having to obtain a Federal, State, or local permit.

In general, on-site actions need comply only with the substantive aspects of these requirements, not with the administrative aspects. That is, neither applications nor other administrative procedures such as permitting or administrative reviews are considered ARARs for actions conducted entirely on-site, and therefore should not be pursued during the remedial planning of the remedial action. However, the RI/FS, Record of Decision, and design documents should demonstrate full compliance with all substantive requirements that are ARARs. Also, other Federal and State program offices should be consulted as appropriate to ensure that remedies are substantively compliant with identified ARARs.

Guidance on Identifying State ARARs

This section describes the basic factors to be considered in identifying State requirements for Superfund remedial actions.

As mandated by CERCLA § 121(d)(2)(A), remedies must comply with "any promulgated standard, requirement, criteria, or limitation under a State environmental or facility siting law that is more stringent than any Federal standard, requirement, criteria, or limitation" if the former is applicable or relevant and appropriate to the hazardous substance or release in question.

States are required by CERCLA to identify State ARARs "in a timely manner," that is, in sufficient time to avoid inordinate delay or duplication of effort in the remedial process. Regions should expect to work closely with their States so that the appropriate ARARs are identified at critical stages in the process. At a minimum, chemical-specific and location-specific ARARs should be identified after site characterization, and action-specific ARARs should be identified after initial screening of alternatives (prior to detailed analysis) for alternatives that pass through the screening. To the extent possible, Regions and States should negotiate to try to resolve any differences of opinion about ARARs.

Eligible Requirements

The statute specifically limits the scope of potential requirements to those that are promulgated. "Promulgated" requirements are laws imposed by State legislative bodies and regulations developed by State agencies that are of general applicability and are legally enforceable.

State advisories, guidance, or other non-binding policies, as well as standards that are not of general application, cannot be treated as requirements under CERCLA. However, as with their Federal counterparts, State advisories may still be considered in determining an appropriate, protective remedy.

General State goals that are duly promulgated (such as a non-degradation law) have the same weight as explicit, numerical standards, although the former have to be interpreted in terms of a site and therefore may allow more flexibility in approach. Similarly, State laws or regulations that prescribe methods for deriving numerical standards for specific cases may also be potential requirements.

On-site actions need comply only with the substantive aspects of a State requirement, not with the administrative aspects. Where the requirement involves review by a State board based on explicit criteria, the best approach is to incorporate the substantive criteria into the RI/FS and remedy selection process and to maintain close consultation with appropriate State representatives.

Limitations on State Siting Laws

CERCLA § 121(d)(2)(C) puts special limitations on the applicability of State requirements or siting laws for hazardous waste facilities that could result in a State-wide prohibition of land disposal. Specifically, in order to be treated as potentially applicable or relevant and appropriate requirements, such laws must:

(1) Be of general applicability and be formally adopted

(2) Be based on technical (e.g., hydrogeologic) or other relevant considerations

(3) Not be intended to preclude land disposal for reasons other than protection of health or environment.

In addition, the State must arrange and pay for additional costs for out-of-State or other disposal necessitated by such a law.

The first criterion is similar to the criterion that a requirement be promulgated, as discussed above. The second criterion requires that such a law be based on sound scientific or technical considerations, such as groundwater flow, surficial geology, and engineering design. The third criterion requires some evidence that health or environmental protection motivates the prescribed restrictions; the introductory sections of a law, the nature of the technical consideration, or the legislative history can be used to make this determination.

Consistency of Application

CERCLA § 121(d)(4)(E) allows a State requirement to be waived if it has not been consistently applied by the State in similar circumstances at other remedial actions. The waiver cannot be used if the State has demonstrated the intention to consistently apply the requirement.

Consistency of application by a State may be determined by examining the following:

—Application of requirement at similar sites or in similar response circumstances (considering nature of contaminants or media affected, characteristics of waste and facility, degree of danger or risk, etc.)

—Proportion of cases (including enforcement actions) in which requirement was not applied out of total actions where it could have been applied

—Reason for non-application of requirement in past cases

—Intention to consistently apply requirement in future as shown by policy statements, legislative history, site remedial planning documents, or State responses to Federal-lead sites; newly promulgated requirements shall be presumed to embody this intention unless there is contrary evidence.

All previous actions by States since promulgation that relate to similar remedial actions may be considered in evaluating consistency.

Guidance on Applying Specified Water Standards

CERCLA § 121(d)(2)(A) and (B) explicitly mention three kinds of surface water or groundwater standards with which compliance is potentially required—Maximum Contaminant Level Goals (MCLGs), Federal Water Quality Criteria (FWQC), and alternate concentration limits (ACLs) where human exposure is to be limited. This section describes these requirements and how they may be applied to Superfund remedial actions. The guidance is based on Federal requirements and policies; more stringent, promulgated State requirements (such as a stricter classification scheme for groundwater) may result in application of even stricter standards than those specified here.

Background

These three standards or criteria each derive from separate statutes and have different purposes and uses.

MCLGs are developed under the Safe Drinking Water Act as chemical-specific health goals used in setting enforceable drinking water standards, known as Maximum Contaminant Levels (MCLs), for public water supply systems. MCLGs are based entirely on health considerations and do not take cost or feasibility into account. Moreover, as health goals MCLGs are set at levels where no known or anticipated health effects may occur, including an adequate margin of safety. MCLs are required to be set as close as feasible to the respective MCLs, taking into consideration the best technology, treatment techniques, and other factors (including cost). However, as the standard for public water supplies, MCLs are fully protective of human health and (for carcinogens) fall within the acceptable risk range of 10^{-4} to 10^{-7}. Furthermore, for non-carcinogens, which are the majority of contaminants, MCLs will nearly always be set at the same level as the respective MCLGs. Also, these standards assure that even sensitive populations will experience no adverse health effects. Thus, there will be no difference in the protectiveness of MCLGs and MCLs for most contaminants, and, as discussed above, MCLs provide a sufficient level of protectiveness even for carcinogens.

FWQC are developed under the Clean Water Act as guidelines from which States determine their water quality standards. Different FWQC are derived for protection of human health and protection of aquatic life.

ACLs are one of three possible Standards available under the Subpart F Groundwater Protection Standards of RCRA. For setting both a trigger and a cleanup level for remediating groundwater contamination, an ACL, the background concentration, or for a small group of chemicals the MCL can be selected for a given site.

Statutory Mandate

CERCLA § 121(d)(2) states that remedial actions shall attain applicable or relevant and appropriate requirements under the Safe Drinking Water Act, the Clean Water Act, and RCRA, and specifically shall attain MCLGs and FWQC where they are relevant and appropriate under the circumstances of the release or threatened release. It further states that for FWQC this determination will be based on the designated or potential use of the water, the media affected, the purposes of the criteria, and current information.

CERCLA § 121(d)(2)(B)(ii) limits the use of ACLs that are set above health-based levels based on projections that health-based levels will be achieved at a likely point of human exposure. Such a point of exposure may not be beyond the Superfund facility boundary unless the groundwater discharges into surface water and does not cause a statistically significant increase of contaminants in the surface water. To apply such an ACL outside the facility, moreover, the remedial action must include enforceable measures to prevent use of any contaminated groundwater.

Application

In determining the applicable or relevant and appropriate requirements for remedial actions involving contaminated surface water or groundwater, the most important factors to consider are the uses and potential uses of the water and the purposes for which the potential requirements are intended.

The actual or potential use of water, and the manner in which it is used, will determine what kinds of requirements may be applicable or relevant and appropriate. For Class III-type groundwater that is not suitable for drinking because of high salinity or widespread contamination and that does not affect drinkable groundwater, drinking water standards are neither applicable nor relevant and appropriate. For Class I- and Class II-type groundwater or surface water that is or may be used for drinking, drinking water standards are applicable or relevant and appropriate, and the surface water or groundwater must ultimately be cleaned up to such levels.

For water that is or may be used for drinking, the Maximum Contaminant Levels (MCLs) set under the Safe Drinking Water Act are generally the applicable or relevant and appropriate standard. MCLs are applicable at the tap where the water will be provided directly to 25 or more people or will be supplied to 15 or more service connections. Otherwise, where surface water or groundwater is or may be used for drinking, MCLs are generally relevant and appropriate as cleanup standards for the surface water or the groundwater.

A standard for drinking water for a contaminant for which there is an MCL may be more stringent than the MCL to ensure adequate protection in special circumstances, such as where either multiple contaminants in groundwater or multiple pathways of exposure present extraordinary risks. In setting a level more stringent than the MCL in such cases, a site-specific determination should be made by considering MCLGs, the Agency's policy on the use of appropriate risk ranges for carcinogens, levels of quantification, and other pertinent guidelines. Prior to consultation with Headquarters is encouraged in such cases.

When MCLs do not exist for contaminants identified at the site, cleanup levels should be set using chemical-specific advisory levels. Cleanup levels should be selected such that the total risk of all contaminants falls within the acceptable risk range of 10^{-4} to 10^{-7}. In cases where non-carcinogens are present, cleanup levels should be based on acceptable levels of exposure as determined by the Reference Dose, taking into account the effects of other contaminants at the site.

It should be noted that while MCLs are generally the cleanup standards, as described above, the treatment necessary to attain an MCL level for one chemical (or a protective level for a chemical without an MCL) may result in an actual level for another chemical that is below its respective MCL (or protective level).

A more stringent FWQC for aquatic life may be found relevant and appropriate when there are environmental factors that are being considered at a site, such as protection of aquatic organisms. The Agency is still formulating a position with respect to the use of FWQC for protection of human health.

Guidance on the use of ACLs based on limitations on exposure will be forthcoming.

Dated: August 6, 1987.

J.W. McGraw,

Acting Assistant Administrator.

[FR Doc. 87-19190 Filed 8-26-87; 8:45 am]

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federal register

Thursday
August 27, 1987

Part VI

Department of the Treasury

Internal Revenue Service

26 CFR Part 1

Affiliated Service Groups, Employee Leasing, and Other Arrangements; Notice of Proposed Rulemaking

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[EE-111-82]

Affiliated Service Groups, Employee Leasing, and Other Arrangements

AGENCY: Internal Revenue Service, Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document provides proposed regulations prescribing rules for determining: (1) When a management organization and the organization for which the management organization performs management services constitute an affiliated service group; (2) when leased employees are treated as employees of the lessee organization for purposes of certain employee benefit provisions; and (3) when arrangements involving separate organizations, employee leasing, or other arrangements will be ignored in order to prevent the avoidance of certain employee benefit requirements.

Changes to the applicable tax law were made by the Tax Equity and Fiscal Responsibility Act of 1982, the Tax Reform Act of 1984, and the Tax Reform Act of 1986. The regulations provide the public with guidance needed to comply with those Acts and would affect employers that maintain, and participants in, qualified plans.

DATES: Written comments and requests for a public hearing must be delivered or mailed by October 26, 1987. The regulations provided by this document are proposed to be generally effective for tax years beginning after December 31, 1983.

ADDRESS: Send comments and requests for a public hearing to: Commissioner of Internal Revenue, Attention: CC:LR:T (EE-111-82), Washington, DC 20224.

FOR FURTHER INFORMATION CONTACT: Michael Garvey of the Employee Plans and Exempt Organizations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC 20224, Attention: CC:LR:T, (202) 566-3903, not a toll-free call.

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed amendments to the Income Tax Regulations (26 CFR Part 1) under sections 414(m)(5), 414(n), and 414(o) of the Internal Revenue Code. These amendments are proposed to conform the regulations to sections 246 and 248 of the Tax Equity and Fiscal Responsibility Act of 1982 (26 U.S.C. 414(m)(5), 414(n)), section 526 of the Tax Reform Act of 1984 (26 USC 414(n)(2), 414(o)), and section 1146 of the Tax Reform Act of 1986 (26 U.S.C. 414(n), 414(o)). Other sections of the Tax Reform Act of 1986 that relate to section 414(n) are not reflected in this document.

Organizations Performing Management Functions

Section 414(m)(5) of the Code expands the definition of an affiliated service group that is to be treated as a single employer under section 414(m) for purposes of certain employee benefit requirements. Pursuant to section 414(m)(5), an affiliated service group includes a management organization and a recipient organization (i.e., the organization (and related organizations) for which the management organization performs management functions). An organization is a management organization if the principal business of the organization is the performing of, on a regular and continuing basis, management functions for a recipient organization.

Employee Leasing

Section 414(n) provides that, under certain circumstances, an individual ("leased employee") who performs services for a person ("recipient") through another person ("leasing organization") shall be treated as the employee of the recipient for purposes of certain employee benefit requirements. If the services being provided by an individual to a recipient are pursuant to an agreement between the recipient and the leasing organization, and the individual performs such services for the recipient on a substantially full-time basis for a period of at least one year, and the services are of a type historically performed by employees, then the individual is a leased employee and, therefore, shall be treated as an employee of the recipient.

Section 414(n)(5) provides, however, that if the leasing organization maintains a safe-harbor plan with respect to a leased employee, such individual will generally not be treated as an employee of the recipient. Section 414(n)(5), as originally enacted, required that a safe-harbor plan must be a qualified money purchase pension plan with provision for nonintegrated employer contributions of at least 7½ percent, immediate participation, and full and immediate vesting.

The Tax Reform Act of 1986 amended several provisions relating to sections 414(n) and 414(o). These amendments include the following:

(1) The definition of a safe-harbor plan under section 414(n)(5) has been amended to require a contribution rate of 10 percent and to require that the plan must cover all employees of the leasing organization (other than employees who perform substantially all of their services for the leasing organization (and not for recipients) and employees whose compensation from the leasing organization is less than $1,000 during the plan year and during each of the 3 prior plan years).

(2) Under section 414(n)(5), a leased employee will be treated as an employee of the recipient, regardless of the existence of a safe-harbor plan, if more than 20 percent of the recipient's nonhighly compensated workforce are leased employees (as specially defined for this purpose).

(3) A recordkeeping exception from the section 414(n) employee leasing provisions is provided under section 414(o) in the case of an employer that has no section 416(g) top-heavy plans and that uses the services of nonemployees only for an insignificant percentage of the employer's total workload.

(4) The scope of the section 414(n) employee leasing provisions has been expanded to include a number of non-pension employee benefit requirements (listed under section 414(n)(3)), including group-term life insurance, accident and health plans, qualified group legal services, cafeteria plans, etc. In addition, the employee leasing provisions will apply to these non-pension employee benefit requirements regardless of the existence of a safe-harbor plan.

Except for the amendments relating to the non-pension employee benefit requirements, the proposed regulations reflect the Tax Reform Act of 1986 amendments described above. Guidance relating to the non-pension employee benefit requirements, and other relevant amendments made by the Tax Reform Act of 1986, will be forthcoming.

Avoidance of Certain Employee Benefits Requirements

Section 414(o) provides that the Secretary shall prescribe such regulations as may be necessary to prevent the avoidance of any employee benefit requirement listed in sections 414(m)(4) or 414(n)(3) through the use of separate organizations, employee leasing, or other arrangements. Specifically, the Secretary has the authority to provide rules in addition to

the rules contained in sections 414(m) and 414(n).

Pursuant to section 414(o), the proposed regulations provide rules relating to several arrangements that may result in the avoidance of the listed employee benefit requirements. These arrangements include the leasing of certain owners, the leasing of certain managers, the creation of successive organizations in time, expense sharing arrangements, plans maintained by certain corporate directors, and plans covering certain five-percent owners.

Effective Dates

The amendments made to section 414 by the Tax Equity and Fiscal Responsibility Act of 1982 are effective for tax years of a recipient or of a member of an affiliated service group that begin after December 31, 1983.

The amendments made to section 414 by the Tax Reform Act of 1984 are effective as of July 18, 1984. The regulations promulgated under section 414(o), however, are variously effective for (1) plan years beginning more than six months after this document is published in the **Federal Register**, (2) plan years beginning more than sixty days after this document is published in the **Federal Register** as a Treasury decision, and (3) plan years beginning during or after the first tax year of a recipient beginning after December 31, 1983. (To the extent that the regulations under section 414(o) aggregate plans for purposes of section 415 that were not previously aggregated, the rules of § 1.415–10 apply.)

The amendments made to section 414 by the Tax Reform Act of 1986 are generally effective with respect to services performed after December 31, 1986. The recordkeeping exception from section 414(n), provided under section 414(o), and certain clarifying amendments under section 414(n) are effective as if originally enacted as part of the section 414 amendments made by the Tax Equity and Fiscal Responsibility Act of 1982. The section 414(n)(3) amendments relating to the non-pension employee benefit requirements are generally effective when section 89 applies to such non-pension employee benefits (see section 1151(k) of the Tax Reform Act of 1986).

Special Analysis

The Commissioner of Internal Revenue has determined this rule is not a major rule as defined in Executive Order 12291. Therefore, a Regulatory Impact Analysis is not required. Although this document is a notice of proposed rulemaking that solicits public comment, the Internal Revenue Service has concluded that the regulations proposed are interpretative and that the notice and public procedure requirements of 5 U.S.C. 553(b) do not apply. Accordingly, these proposed regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. chapter 6).

Comments and Requests for a Public Hearing

Before adopting these proposed regulations, consideration will be given to any written comments that are submitted (preferably eight copies) to the Commissioner or Internal Revenue. All comments will be available for public inspection and copying. A public hearing will be held upon written request the Commissioner by any person who has submitted written comments. If a public hearing is held, notice of the time and place will be published in the **Federal Register**.

Drafting Information

The principal author of these proposed regulations is Philip R. Bosco of the Employee Plans and Exempt Organizations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury participated in developing the regulations, both on matters of substance and style.

List of Subjects in 26 CFR 1.401–1–1.425–1

Employee benefit plans, Pensions.

Proposed Amendments to the Regulations

The Income Tax Regulations (26 CFR Part 1) are proposed to be amended as follows:

Paragraph 1. The authority citation for Part 1 is amended by adding the following citation:

Authority: 26 U.S.C. 7805. * * * Section 1.414(n)–1 also issued under 26 U.S.C. 414(n). Section 1.414(o)–1 also issued under 26 U.S.C. 414(o).

Par. 2. The following new sections are added immediately following § 1.414(m)–4 and read as follows:

§ 1.414(m)–5 Organizations performing management functions.

(a) *In general*—(1) *Affiliated service group.* Pursuant to section 414(m)(5), an affiliated service group includes a group consisting of a management organization (as defined in paragraph (a)(3) of this section) and a recipient organization (as defined in paragraph (a)(4) of this section).

(2) *Organization.* For purposes of this section, the term "organization" means a sole proprietorship, partnership, corporation, trust, association, company, estate, or any other type of entity, regardless of its ownership format.

(3) *Management organization.* For purposes of this section, the term "management organization" means—

(i) An organization, and

(ii) All organizations aggregated (as provided in paragraph (a)(5) of this section) with the organization identified in paragraph (a)(3)(i) of this section, the principal business of which is to perform on a regular and continuing basis management functions for a recipient organization.

(4) *Recipient organization.* For purposes of this section, the term "recipient organization" means—

(i) An organization for which management functions are performed,

(ii) All organizations aggregated (as provided in paragraph (a)(5) of this section) with the organization identified in paragraph (a)(4)(i) of this section, and

(iii) All organizations related (as provided in paragraph (a)(6) of this section) to any organization identified in paragraphs (a)(4)(i) or (a)(4)(ii) of this section.

(5) *Aggregated organizations.* For purposes of this section, organizations are aggregated pursuant to section 414 (b), (c), (m), and (o).

(6) *Related organizations.* For purposes of this section, an organization ("first organization") is related to an organization identified in paragraphs (a)(4)(i) or (a)(4)(ii) of this section ("second organization") if such first organization and second organization would be related persons pursuant to section 144(a)(3) and the management organization performs management functions for the first organization.

(7) The provisions of this paragraph may be illustrated by the following examples:

Example (1). Assume that Corporations A and B constitute a controlled group of corporations under section 414(b) and that Corporations C and D constitute an affiliated service group under section 414(m)(2). Assume that C or D (or both) perform management functions and other services for A or B (or both) that satisfy the requirements of paragraph (b) of this section. C and D are treated as a single management organization and A and B are treated as a single recipient organization for purposes of section 414(m)(5). A, B, C, and D constitute an affiliated service group under section 414(m)(5).

Example (2). Assume the same facts as in example (1). In addition, assume that Corporation E is related to A or B under paragraph (a)(6) of this section (but not aggregated with A or B under paragraph (a)(5) of this section). Assume further that C or D (or both perform management functions and other services for E that satisfy the

requirements of paragraph (b) of this section. E is included with A and B as a single recipient organization, A, B, C, D, and E constitute an affiliated service group under section 414(m)(5).

Example (3). Assume the same facts as in example (2). In addition, assume that Corporation F is related to C or D under section 114(a)(3) (but not aggregated with C or D under paragraph (a)(5) of this section). F is not part of the A–B–C–D–E affiliated service group solely by virtue of its relationship to C or D, even if it provided management functions to A, B, or E. If, however, F (regardless of whether F is related to C or D) satisfies the requirements of paragraph (b) of this section as a management organization with respect to the A–B–C–D–E affiliated service group, then, A, B, C, D, E, and F constitute an affiliated service group.

(b) *Determination of principal business on a regular and continuing basis*—(1) *Two-tax-year rolling percentage.* Except as provided in paragraph (b)(2) of this section, a management organization shall exist with respect to a particular recipient organization for a tax year of the management organization during which the performance of management functions and other services for the recipient organization constitutes more than 50 percent of the management organization's business activities during the two-tax-year period that includes such tax year and the prior tax year. If the management organization was not in existence prior to the current tax year, the more-than-50-percent test shall apply only to the current tax year. Once the more-than-50-percent test is met, the management organization will continue to be a management organization with respect to a particular recipient organization for each subsequent tax year during which the performance of management functions and other services for such recipient organization constitutes more than 40 percent of the management organization's business activities during the two-tax-year period that includes such subsequent tax year and the immediately preceding tax year, unless—

(i) The performance of management functions and other services for the recipient organization constitutes less than five percent of the management organization's business activities during such subsequent tax year,

(ii) There is an intervening tax year for which the management organization and the recipient organization do not satisfy the more-than-40-percent test, or

(iii) The management organization satisfies the more-than-50-percent test with respect to a different recipient organization for such subsequent tax year and the immediately preceding tax year.

If one or more of the three exceptions described in this paragraph (b)(1) applies to a management organization and a particular recipient organization for a tax year, whether such organization is a management organization for such tax year (with respect to either the same or a different recipient organization) or whether such organization becomes a management organization for a subsequent tax year (with respect to either the particular or a different recipient organization) will be determined by reapplication of the more-than-50-percent-test of this paragraph (b)(1) to such organization for the applicable tax year.

(2) *Insubstantial management functions.* Notwithstanding anything in this paragraph (b) to the contrary, a management organization shall not exist with respect to a particular recipient organization for a tax year of the management organization during which the performance of management functions for such recipient organization, in relation to all services performed for such recipient organization, is not substantial. The performance of management functions for a recipient organization is not substantial for a tax year only if during such tax year less than 50 percent of the compensation provided by the management organization, with respect to services performed for the recipient organization (including services performed as an employee of the management organization and in any other capacity), is provided to individuals who perform a significant amount of management functions for the recipient organization. An individual performs a significant amount of management functions for the recipient organization if, during the tax year, at least 15 percent of the individual's service (including service performed as an employee of the management organization and in any other capacity) for the recipient organization (based on time) is performing management functions for the recipient organization. For purposes of this paragraph (b)(2), the term "compensation" means (i) with respect to services performed as a common-law employee, compensation reportable on Form W–2, and (ii) with respect to services performed as a self-employed individual (as defined in section 401(c)(1)), earned income as defined in section 401(c)(2).

(3) *Use of gross receipts to determine principal business.* Except as provided in paragraph (b)(4) of this section, the principal business determination under paragraph (b)(1) of this section is made on the basis of the percentage of gross receipts derived from management functions and other services performed for a recipient organization, as compared to the gross receipts derived from all business activities. In determining the two-tax-year percentage for purposes of paragraph (b)(1) of this section, gross receipts for the combined two-tax-year period are compared. Thus, it is not permissible to average the percentages determined separately for each tax year. For purposes of this paragraph (b), gross receipts derived from all business activities do not include gross receipts from the sale of any asset.

(4) *Use of facts and circumstances to determine principal business.* The Commissioner may, at his discretion, determine that the use of gross receipts is not an appropriate method for determining principal business. In that event, the determination of principal business shall be made on the basis of all relevant facts and circumstances including, for example, the amount of time actually spent by individuals in performing management functions and other services for a recipient organization. The determination that the use of gross receipts is not an appropriate method for determining principal business may not be made by the taxpayer.

(5) *Aggregated organizations with different tax years.* If management organizations aggregated pursuant to paragraph (a)(3) of this section have different tax years, any 12-month period used at any time by such organization may be used for purposes of this paragraph (b) provided that the 12-month period selected is used consistently.

(c) *Management functions*—(1) *Definition.* For purposes of this section, the term "management functions" includes only those management activities and services historically performed by employees. Management activities and services include determining, implementing, or supervising (or providing advice or assistance in accomplishing any of the foregoing)—

(i) Daily business operations (such as production, sales, marketing, purchasing, advertising, etc.),

(ii) Personnel (such as staffing, training, supervising, hiring and firing, etc.),

(iii) Employee compensation and benefits (such as salaries and wages, paid vacations and holidays, life and health insurance, pensions, etc.),

(iv) Short- and long-range business planning (such as product development,

budgeting, financing, expansion of operations, capital investment, etc.),

(v) Organizational structure and ownership (such as corporate formation, stock issues, dividends, mergers and acquisitions, etc.), and

(vi) Any other management activity or service.

Management activities and services also include professional services (as defined in § 1.414(m)-1(c)) that relate to the activities and services described in this paragraph (c)(1). In addition, professional services of the same type as the professional services performed by the recipient organization for third parties are deemed to be management activities and services, and are deemed to be management functions regardless of whether such professional services are historically performed by employees.

(2) *Historically performed by employees*—(i) *In general.* Management activities and services are historically performed by employees in a particular business field (such as the health field) if it was not unusual for management activities and services of such type to be performed by employees of organizations in that particular business field, in the United States, on September 3, 1982. To the extent that a particular business field did not exist on September 3, 1982, whether a management activity or service will be considered historically performed by employees in that particular business field will be determined by analogy to similar business fields in existence on September 3, 1982. The Commissioner may provide additional guidance as to what constitutes a business field.

(ii) *Management activity or service actually performed by employees.* Notwithstanding a determination under paragraph (c)(2)(i) of this section that it was unusual for a particular management activity or service to be performed by employees of organizations in a particular business field, if such management activity or service was ever performed by any employee of a particular organization in such business field, such management activity or service is a management activity or service historically performed by employees for purposes of applying section 414(m)(5) to that particular organization (and to organizations aggregated with such organization under paragraph (a)(5) of this section and to organizations which would be related to any of the foregoing organizations under paragraph (a)(6) of this section if such management activity or service were considered a management function for purposes of such paragraph (a)(6)), for the period beginning on the date such management activity or service was first performed by an employee of that organization and ending on the date five years after such management activity or service is no longer performed by an employee of that organization.

(d) *Treatment of self-employed individuals.* For purposes of this section, the term "employee" includes a self-employed individual (as defined in section 401(c)(1)).

(e) *Services performed means services performed directly or indirectly.* For purposes of this section, services performed for a person other than as an employee of such person means services performed directly or indirectly for such person.

§ 1.414(m)-6 Application of section 414(o) to section 414(m).

Section 414(o) provides that the Secretary shall prescribe such regulations (which may provide rules in addition to the rules contained in section 414 (m) as may be necessary to prevent the avoidance of any employee benefit requirement listed in section 414(m)(4) through the use of separate organizations, employee leasing, or other arrangements. Accordingly, the regulations under section 414(m) are promulgated, in part, pursuant to the authority granted by section 414(o). For additional rules that may relate to section 414(m), see section 414(o) and the regulations thereunder.

§ 1.414(n)-1 Employee leasing.

(a) *In general.* Section 414 (n) provides that under certain circumstances, an individual who is a leased employee shall be treated as an employee of the recipient for purposes of the employee benefit requirements listed in § 1.414(n)-3 (a).

(b) *Definitions*—(1) *Leasing organization.* The term "leasing organization" means any aggregated group (as defined in paragraph (b)(6) of this section without regard to paragraph (b)(6)(ii) of this section) which provides services to a recipient through a leased employee. An aggregated group may be both the leasing organization and the leased employee, such as where a sole proprietor performs services for a recipient as an independent contractor.

(2) *Recipient.* The term "recipient" means any aggregated group (as defined in paragraph (b)(6) of this section) which utilizes the services of a leased employee.

(3) *Person.* The term "person" means any individual, sole proprietorship, trust, estate, partnership, association, company, or corporation. Whether persons are related is determined pursuant to the rules of section 144(a)(3).

(4) *Leased employee.* The term "leased employee" means any individual who provides services to a recipient, in a capacity other than as an employee of the recipient, in accordance with each of the following three requirements:

(i) The services are provided pursuant to one or more agreements between the recipient and one or more leasing organizations.

(ii) The individual has performed such services for the recipient on a substantially full-time basis for a period of at least one year.

(iii) Such services are of a type historically performed, in the business field of the recipient, by employees.

(For purposes of this paragraph (b)(4), the terms, "recipient" and "leasing organization" mean such person or persons that would constitute a "recipient" or "leasing organization" if the individual were a leased employee.) If the three requirements of this paragraph (b) (4) are satisfied, an individual generally becomes a leased employee with respect to a recipient as of the first day immediately following the end of the one-year period specified in paragraph (b) (4) (ii) of this section. However, an individual may become a leased employee with respect to a recipient as of the beginning of the one-year period specified in paragraph (b) (4) (ii) of this section if the recipient elects such treatment with respect to all individuals who satisfy paragraph (b) (4) (i) and (iii) of this section. An individual need not be an employee of the leasing organization to be a leased employee. For example, an individual may be an independent contractor or leased employee with respect to the leasing organization.

(5) *Agreement.* For purposes of paragraph (b) (4) (i) of this section, an agreement between the recipient and the leasing organization includes any mutual understanding between the parties that the leasing organization will provide an individual or individuals to perform services for the recipient. This agreement need not be in writing. An agreement will be deemed to exist with respect to an individual if the leasing organization receives or is entitled to payment from the recipient in exchange for providing the individual to perform services for the recipient.

(6) *Aggregation of related or aggregated recipients.* For purposes of section 414(n) and the regulations thereunder, the term "aggregated group" means—

(i) All persons aggregated pursuant to section 414 (b), (c), (m), or (o), and

(ii) All persons related, in accordance with section 414 (a)(3), to any person aggregated under paragraph (b)(6)(i) of this section.

(7) *Performance of services through multiple leasing organizations.* For purposes of paragraph (b)(4)(ii) of this section, if a individual performs services for a recipient pursuant to one or more agreements between the recipient and one or more leasing organizations, all such services are included.

(8) *Performance of services prior to the effective date of section 414(n) or while covered by a safe-harbor plan.* For purposes of paragraph (b)(4)(ii) of this section, services performed by an individual prior to the effective date of section 414(n) are included. For example, assume that an individual began performing services for a recipient on June 1, 1982. If by June 1, 1983, the individual has performed the requisite number of hours of service for the recipient, and the other requirements of section 414(n)(2) are met, such individual is a leased employee of the recipient as of the first date on which section 414(n) applies with respect to the recipient. For purposes of paragraph (b)(4)(ii) of this section, services performed by an individual while covered by a safe-harbor plan (as defined in paragraphs (f) and (g) of § 1.414(n)–2) are included.

(9) *Performance of services as an employee.* For purposes of paragraph (b)(4)(ii) of this section, services performed at any time by an individual as an employee of a recipient are included.

(10) *Substantially full-time basis for a period of at least one year*—(i) *General rule.* For purposes of paragraph (b)(4)(ii) of the section, an individual is considered to have performed services or a substantially full-time basis for a period of at least one year if by the end of the individual's initial 12-month period of performing services for the recipient, or by the end of any plan year of the recipient beginning either during or after the individual's initial 12-month period of performing services for the recipient, such individual is credited with either—

(A) At least 1500 hours of service for the recipient, or

(B) At least 501 hours of service for the recipient and a number of hours of service for the recipient equal to at least 75 percent of the median number of hours of service credited during the same period to individuals who during the entire period perform similar services for the recipient as employees of the recipient. Under certain circumstances, it may be appropriate to base the determination under paragraph (b)(10)(i)(B) of this section on similar services performed by individuals other than current employees of the recipient. For example, if no individuals currently perform similar services for the recipient as employees of the recipient, it may be appropriate to determine the median based on individuals who performed similar services for the recipient as employees of the recipient in a prior plan year. If the recipient has plans with more than one plan year, the recipient may use the plan year of any plan, provided such plan year is used on a consistent basis for all determinations of whether any individual has performed services on a substantially full-time basis for a period of at least one year.

(ii) *Exceptions to the general rule.* Notwithstanding paragraph (b)(10)(i) of this section—

(A) All individuals credited with at least 501 hours of service for the recipient during a period described in paragraph (b)(10)(i) of this section may, at the option of the recipient, be considered to have performed services on a substantially full-time basis for a period of at least one year, and

(B) All individuals credited with less than 1,000 hours of service for the recipient during a period described in paragraph (b)(10)(i) of this section may, at the option of the recipient, be considered to have not performed services during such period which would cause such individual to be considered to have performed services on a substantially full-time basis for a period of at least one year.

(C) With respect to a period described in paragraph (b)(10)(i) of this section, a recipient may apply paragraph (10)(ii)(A) or (B) of this section by substituting for 501 hours of service or 1,000 hours of service (as the case may be) any specified number of hours of service between 501 and 1,000.

(iii) *Hours of service.* For purposes of this paragraph (b)(10), the term "hours of service" has the same meaning as the term "hour of service" provided by 29 CFR § 2530.200b–2 under the general method of crediting service for an employee. Hours of service for the recipient include hours of service for the leasing organization during which no services for the recipient are performed to the extent that such hours of service are attributable to the recipient. For example, if an individual performs services for the recipient totaling 900 hours, performs services for another person total 100 hours, and receives paid sick leave from the leasing organization totaling 200 hours, hours of service for the recipient includes a proportional amount of the 200 hours of paid sick leave (i.e., 180 hours). If one of the equivalencies set forth in 29 CFR 2530.200b–3 is used with respect to an individual for crediting hours of service, the selected equivalency must be identified, in writing, pursuant to a nondiscriminatory agreement between the leasing organization and the recipient. If an equivalency is used, the hour requirements in this paragraph (b)(10) must be adjusted accordingly. For example, if the equivalency in 29 CFR 2530.200b–3 (d)(1) based on hours worked is used, the 1,000 hours reference in paragraph (b)(10)(ii)(B) of this section must be adjusted to 870. If an equivalency is used with respect to an individual, then for purposes of determining whether such individual, then for purposes of determining whether such individual has performed services on a substantially full-time basis for a period of at least one year, the same equivalency must be used for determining the hours of service of employees of the recipient under paragraph (b)(10)(i)(B) of this section.

(iv) *Alteration of plan year.* For purposes of this paragraph (b)(10), rules similar to those provided under 29 CFR 2530.230–2 (c)(1) shall apply in the case of an amendment to alter the plan year.

(v) *Other rules.* For purposes of this paragraph (b)(10), the Commissioner may provide additional methods for determining hours of service and the application of paragraph (b)(10)(iv) of this section.

(11) *Examples.* The provisions of this paragraph may be illustrated by the following examples.

Example (1). On July 1, 1986, Corporation X leases Individual A from Leasing Organization Y to perform secretarial services. Y does not maintain a qualified plan. The median number of hours of service credited to secretaries who are employed by X throughout the year is 35 hours per week or 1,820 hours per year. During the 12-month period ending on June 30, 1987, A is credited with 1,450 hours of service for X. A does not meet the first test of "substantially full-time" because A was not credited with at least 1,500 hours of service. However, A does meet the second test for "substantially full-time" because A is credited with a number of hours of service equal to at least 75 percent of the median number of hours of service credited to employees of X who perform secretarial services throughout the year (.75×1,820 hours=1,365 hours). Therefore, A is a leased employee of X as of July 1, 1987.

Example (2). Individual B was an employee of Corporation X, a calendar year taxpayer, on a full-time basis from January 1, 1980 until July 1, 1982. On May 1, 1984, B is hired by and becomes an employee of Leasing Organization Z. Z is not related to X. Z enters into a contract with X to provide services to

X. On May 2, 1984, B is leased to X. B is not an employee of X. B is considered to be a leased employee of X for purposes of section 414(n) as of May 2, 1984, because service performed by B for the recipient as an employee is taken into account for purposes of determining whether an individual has performed services on a substantially full-time basis for a period of at least one year.

(12) *Historically performed by employees*—(i) *In general.* For purposes of paragraph (b)(4)(iii) of this section, services are historically performed by employees in a particular business field (such as the health field) if it was not unusual for services of such type to be performed by employees of persons in that particular business field, in the United States, On September 3, 1982. To the extend that a particular business field did not exist on September 3, 1982, whether a service will be considered historically performed by employees in that particular business field will be determined by analogy to similar business fields in existence on Septemer 3, 1982. The Commissioner may provide additional guidance as to what constitutes a business field.

(ii) *Services actually performed by employees.* Notwithstanding a determination under paragraph (b)(12)(i) of this section that it was unusual for a particular service to be performed by employees of persons in a particular business field, if such service was ever performed by any employee of a particular person in such business field, such service is a service historically performed by employees for purposes of applying section 414(n) to the aggregated group of which that particular person is a part, for the period beginning on the date such service was first performed by any employee of that person and ending on the date five years after such service is no longer performed by any employee of that person.

(iii) *Examples.* The provisions of this paragraph may be illustrated by the following examples.

Example (1). On January 1, 1987, Law Firm X contracts with Construction Company Y to renovate an existing building that will become X's new law office. By December 31, 1987, each of five employees of Y who began performing services for X on January 1, 1987, has been credited with at least 1500 hours of service for X. X has never had an employee perform construction services. None of the five employees of Y is a leased employee of X as of January 1, 1988, because it was unusual for construction services to be performed by employees of a law firm, in the United States, on September 3, 1982.

Example (2). On September 15, 1986, Corporation X, a textile manufacturer, contracts with Corporation Y, a construction firm, to build a manufacturing plant for X. By September 14, 1987, each of 15 employees of Y who began performing services for X on September 15, 1986, is credited with at least 1500 hours of service for X. X has never had an employee perform construction services. None of the 15 employees of Y is a leased employee of X as of September 15, 1987, because it was unusual for construction services to be performed by employees of a textile manufacturer, in the United States, on September 3, 1982.

(13) *Effect on substantially full-time service*—(i) An individual who at one time satisfied the requirements of paragraph (b)(4)(ii) of this section may, at the recipient's election, cease to be considered to have satisfied the requirements of such paragraph as of the end of the first year in which the individual's number of consecutive nonqualifying years equals or exceeds the greater of either five years or the aggregate number of qualifying years.

(ii) For purposes of this paragraph (b)(13), the term "year" means the period described in paragraph (b)(10)(i) of this section for determining whether an individual has performed services on a substantially full-time basis for a period of at least one year, including periods prior to the effective date of section 414(n).

(iii) For purposes of this paragraph (b)(13), the term "nonqualifying year" means a year during which an individual has less than 501 hours of service for the recipient.

(iv) For purposes of this paragraph (b)(13), the term "qualifying year" means each year other than a nonqualifying year, starting with the first year in which the individual performed services on a substantially full-time basis within the meaning of paragraph (b)(10) of this section.

(v) For purposes of this paragraph (b)(13), the definitions and rules of paragraphs (b)(10)(iii) and (b)(10)(iv) of this section shall apply.

(14) *Simplified employee pensions.* For purposes of section 414(n) and the regulations thereunder, references to a "plan" or to a "qualified plan" of the recipient or the leasing organization shall, to the extent appropriate, include simplified employee pensions under section 408(k).

(15) *Treatment of self-employed individuals.* For purposes of section 414(n) and the regulations thereunder, the term "employee" includes a "self-employed individual" (as defined in section 401(c)(1)).

(16) *Highly compensated employees, etc.* For purposes of section 414(n) and the regulations thereunder, a leased employee of a recipient may be considered an employee of the recipient who is highly compensated, an officer, or a shareholder. See § 1.414(o)–1(m). See section 414(q) for the definition of "highly compensated employee" for years beginning after December 31, 1986 or later, depending on the applicable effective date for the particular employee benefit requirement.

(17) *Services performed means services performed directly or indirectly.* For purposes of section 414(n) and the regulations thereunder, services performed for a person other than as an employee of such person mean services performed directly or indirectly for such person.

(c) *Effect of section 414(n) on other sections.* Notwithstanding that, pursuant to section 414(n), a leased employee is treated as an employee of the recipient for purposes of the employee benefit requirements provided in section 414(n)(3) and § 1.414(n)–3 (a), a leased employee may still be an employee of the leasing organization. Therefore, if a leased employee is an employee of the leasing organization, rather than being self-employed or an independent contractor with respect to the leasing organization, the leased employee may be a participant in the plans of both the leasing organization and the recipient.

(d) *Effect of section 414(n) on employee rules*—(1) *In general.* Section 414(n) operates after the application of the common-law rules relating to the determination of the employer/employee relationship. Thus, for example, an individual who is an employee of a person will continue to be an employee of that person even though the person formally "leases" the individual from a leasing organization that maintains a safe-harbor plan described in section 414(n)(5). In addition, compensation received by such an individual that is attributable to services performed for the person as an employee of the person may not be considered for purposes of determining whether any plan maintained by the leasing organization is qualified pursuant to section 401.

(2) *Determination of employer.* The determination of who is the employer of an individual for purposes of sections 3121, 3306, and 3401 (relating to employment taxes and income tax withholding) is not determinative of who is the employer for purposes of subchapter D.

(e) *Exception for certain leased employees*—(1) *In general.* For purposes of section 414(n) and the regulations thereunder, an individual who is a leased employee of a recipient shall not be treated as an employee of the recipient for a tax year of the leased employee for which each of the following conditions is satisfied:

(i) The leased employee provides services for the recipient that require the use by the leased employee of substantial operating assets ("required operating assets"). Required operating assets are treated as substantial only if the "replacement cost" of such assets in the leased employee's taxable year of purchase of such assets equals or exceeds the "applicable amount" for the calendar year in which such taxable year of purchase begins.

(A) For purposes of this paragraph (e)(1)(i), the "applicable amount" for calendar years before 1988 is $60,000. The "applicable amount" for calendar years after 1987 shall be determined by the Commissioner by annually adjusting the applicable amount for the prior calendar year to take into account increases in the cost of living. Such increases shall be made in accordance with procedures used to adjust benefits under section 215(i)(2)(A) of the Social Security Act.

(B) The "replacement cost" of required operating assets that are new in the leased employee's year of purchase shall be the leased employee's actual cost of such assets (e.g., the amount paid in cash and other property), excluding any taxes paid with respect to such purchase.

(C) The "replacement cost" of required operating assets that are previously used as of the leased employee's year of purchase is the retail cost in such year of purchase of new required operating assets that are comparable to the previously used required operating assets actually purchased by the leased employee. Thus, for example, if a leased employee purchases a previously used required operating asset in 1987, such asset will be treated as substantial for purposes of this provision if the retail cost of a new operating asset that is comparable to the previously used required operating asset equals or exceeds the applicable amount for 1987. The comparability of a previously used asset to a new asset is to be determined by reference to all the facts and circumstances, including any standard and extra features included with the respective assets.

(D) At the election of the leased employee, the determination of whether required operating assets purchased by a leased employee prior to the leased employee's taxable year beginning in 1987 are substantial may be made as if such assets were previously used assets first purchased by the leased employee in such leased employee's taxable year beginning in 1987.

(E) The determination of whether required operating assets are substantial (i.e., whether the replacement cost of such assets equals or exceeds the applicable amount for the year of purchase) is made in the leased employee's taxable year in which the assets are acquired by the leased employee. The determination, once made, remains in effect with respect to such assets for as long as the leased employee owns the assets. Thus, if the leased employee's replacement cost of required operating assets equals or exceeds the applicable amount for the year of purchase, the required operating assets will be treated as substantial for the year of purchase and for all subsequent years that the leased employee continues to own the assets, even if the basis or value of the assets declines in subsequent years. Similarly, if required operating assets are not substantial in the year of purchase, such assets will not be treated as substantial for the year of purchase or for any subsequent year, even if the value of such assets increases.

(ii) The leased employee's actual cost of the required operating assets in the leased employee's taxable year of purchase (whether or not such assets are previously used or new) equals or exceeds the "minimum amount" for the calendar year in which such taxable year of purchase begins. For purposes of this paragraph (e)(1)(ii), the "minimum amount" for calendar years before 1988 is $10,000. The "minimum amount" for calendar years after 1987 shall be adjusted annually in accordance with paragraph (e)(1)(i)(A).

(iii) (A) The leased employee owns substantially all of the required operating assets used in the leased employee's performance of services for the recipient. For purposes of this determination, the ownership interest of a leased employee and his or her spouse shall be aggregated. However, the ownership interest of the leased employee (and the spouse of the leased employee) will not be aggregated with the ownership interest of any other person for purposes of this determination. A leased employee will be treated as owning substantially all of the required operating assets only if the leased employee (and the spouse of the leased employee) own 85 percent or more of such assets at all times during the tax year of the leased employee. A leased employee will be treated as owning the required operating assets only to the extent that such leased employee bears the full risk of loss with respect to such assets and the full responsibility for the operating expenses with respect to such assets. The leased employee will not be treated as bearing the full risk of loss with respect to such assets during a tax year if an asset acquisition loan from the recipient to the leased employee is outstanding or if the recipient is a guarantor or co-borrower of an asset acquisition loan made to the leased employee. For purposes of the preceding sentence, the recipient includes any organization aggregated with the recipient under section 414 (b), (c), (m) or (o). The leased employee will not be treated as failing to bear the full risk of loss with respect to substantial operating assets merely because the leased employee maintains insurance covering damage to, or loss of, substantial operating assets.

(B) For purpose of paragraph (e)(1)(iii)(A) of this section, an asset acquisition loan is a loan any portion of the proceeds of which is used at any time, directly or indirectly, to acquire any of the assets used by the leased employee in performing services. Whether any portion of the proceeds of a loan is used indirectly to acquire any assets used by the leased employee in performing services shall be determined from the facts and circumstances of each case.

(C) For purposes of paragraph (e)(1)(iii)(A) of this section, the leased employee will not be treated as bearing the full responsibility for payment of the operating expenses incurred in performing services for the recipient if the payment by the recipient to the leased employee is determined with reference to the amount of such operating expenses (e.g., a "cost plus" arrangement).

(iv) Less than 50 percent of the amount paid by the recipient to the leased employee is attributable to the personal services of the leased employee for the recipient. This determination will be made by comparing the amount paid by the recipient to the leased employee to the amount the recipient would pay an employee (that performs only personal services for the recipient) providing the same service to the recipient.

(v) The leased employee has no ownership interest in the recipient (or in any organization aggregated with the recipient under section 414 (b), (c), (m), or (o)) at any time during the two-tax-year period consisting of the current tax year and the preceding tax year of the leased employee. In determining the leased employee's ownership interest in the recipient (or in any organization aggregated with the recipient under section 414 (b), (c), (m) or (o)), the principles of section 318(a) shall apply.

(2) *Exception to general rule.* Notwithstanding paragraph (e)(1) of this section, the Commissioner may treat a leased employee described in that

paragraph as an employee of the recipient if the Commissioner considers such treatment to be appropriate under the facts and circumstances of the particular case.

§ 1.414(n)–2 Qualified plan coverage of leased employees.

(a) *Recipient's qualified plan*—(1) *Treatment of leased employees.*

(i) Section 414(n) requires that a leased employee be treated as an employee of the recipient. Therefore, a recipient's qualified plan must specifically provide how leased employees will be treated under the plan. If a recipient's plan does not specifically provide for the treatment of leased employees, such plan will fail to qualify under section 401(a).

(ii) If a recipient's qualified plan covers one or more leased employees, such plan must, as a condition of plan qualification, specifically provide how leased employees covered by a safe-harbor plan (as defined under paragraphs (f) and (g) of this section) will be treated under the recipient's plan.

(iii) The requirements of this paragraph (a)(1) must be satisfied whether or not the recipient utilizes the services of leased employees.

(2) *Participation.* Section 414(n) does not necessarily require that a leased employee benefit under the recipient's qualified plan. Therefore, although a leased employee must be taken into account for purposes of determining whether the recipient's plan is qualified (e.g., whether the plan meets the coverage test of section 410(b) and otherwise satisfies the requirements of section 401(a)), the leased employee is not required to benefit under the recipient's plan. For example, assume that for 1984, Company X has 500 employees who have completed one or more years of service. In addition, X maintains a qualified plan in which 400 of these employees participate. The plan requires an employee to complete one year of service before participation, but does not impose a minimum age requirement. Section 414(n) requires that, for 1984, Company X must treat 25 leased employees as its employees. Even if all of the 25 leased employees satisfy the service requirement, but none of the 25 leased employees is permitted to participate under X's plan for 1984, the plan will still benefit 76.2 percent (400/525) of X's employees and thus will satisfy section 410(b). Thus, X's plan is not required to benefit any of the 25 leased employees for 1984.

(b) *Contributions, benefits, etc., provided by a leasing organization*—(1) *General rule.* (i) For purposes of section 414(n) and the regulations thereunder, a leased employee's "interest in a leasing organization's qualified plan" (i.e., any contributions, forfeitures, or benefits of a leased employee under a qualified plan maintained by a leasing organization that are attributable to services performed for a recipient by the leased employee) is treated as provided under a qualified plan of the recipient for purposes of applying the employee benefit requirements listed in § 1.414(n)–3(a) (except for paragraph (a)(6) of that section) to any qualified plan of the recipient. In addition, the leased employee's "interest in the leasing organization" (i.e., the leased employee's interest in the factors relevant to contributions or benefits under any qualified plan of the recipient, such as, for example, compensation, service and accrued benefit, etc.) that is attributable to services performed for the recipient is treated as provided by the recipient. For purposes of this section, except as otherwise provided, the factors relevant to contributions or benefits under any qualified plan of the recipient are to be determined in a manner consistent with the definition of such factors under the recipient's plan (or plans) and with section 401(a) (4) and (5). For example, the term "compensation" means compensation determined in a manner consistent with the definition of compensation under the recipient's plan (or plans) and with section 401(a) (4) and (5). For purposes of this section, the term "compensation" includes earned income as defined in section 401(c)(2). See section 414(s) for the definition of "compensation" for years beginning after December 31, 1986. For purposes of this section, the term "maintained", when used in the context of a plan maintained by any person, means "maintained at any time".

(ii) The rules of this paragraph (b) do not apply in a converse manner to the leasing organization. For example, contributions or benefits of the leased employee under a qualified plan maintained by the recipient that are attributable to services performed for the recipient by the leased employee, are not treated as provided under a qualified plan of the leasing organization for purposes of applying the employee benefit requirements listed in § 1.414(n)–3(a) to any qualified plan maintained by the leasing organization.

(2) *Allocation of contributions, benefits, etc.* The allocation to the recipient of the leased employee's interest in the leasing organization's qualified plan (and the allocation of each item in the leased employee's interest in the leasing organization) is generally the ratable portion determined on the basis of the proportion of the leased employee's compensation received from the leasing organization attributable to services performed for the recipient to the leased employee's total compensation received from the leasing organization. However, with respect to certain items, such as service or contributions based on a factor other than compensation, an allocation based on other factors (such as hours of service with respect to service) may be appropriate, depending on the facts and circumstances.

(3) *Effect of allocation on recipient's qualified plans.* (i) Each leased employee's interest in a leasing organization's qualified plan that is treated as being provided under a recipient's qualified plan is treated as provided under a qualified plan of the recipient that is separate from any of the plans actually maintained by the recipient. Thus, for example, if a recipient has three leased employees (one each from three separate leasing organizations), the contributions, forfeitures and benefits provided to each of these leased employees under the qualified plans of their respective leasing organizations are treated as provided under three separate qualified plans of the recipient.

(ii) A separate qualified plan for a leased employee that is treated as maintained by the recipient is treated as a qualified plan to the extent that the qualified plan of the leasing organization covering the leased employee is a qualified plan. (However, see § 1.414(o)–1 (b), (c), and (g) in the case of certain leased owners, leased managers and inside corporate directors.)

(iii) If any qualified plan actually maintained by the recipient fails to satisfy any applicable employee benefit requirement (other than section 401(a)(26)), the qualified plan actually maintained by the recipient may be combined with one or more of the separate qualified plans for leased employees that are treated as maintained by the recipient for purposes of satisfying such requirements. Thus, for example, if a plan actually maintained by a recipient would satisfy section 410(b) if it covered one more employee, such plan and any separate qualified plan for a leased employee that is treated as maintained by the recipient may be treated as a single plan for purposes of applying section 410(b). The plans actually maintained by the recipient and the plans treated as maintained by the recipient must also be treated as a single plan for purposes of applying any other applicable employee

benefit requirement to a plan actually maintained by the recipient.

(iv) If a separate qualified plan is treated as maintained by the recipient with respect to a leased employee and such leased employee also participates in a qualified plan actually maintained by the recipient, or has or had accrued benefit in any plan actually maintained by the recipient, then the leased employee's interest in the leasing organization's qualified plan is to be treated as provided to the leased employee under the plan actually maintained by the recipient for purposes of determining whether a plan actually maintained by the recipient satisfies the applicable employee benefit requirements. See paragraph (b)(1)(i) of this section with respect to the term "interest in a leasing organization's qualified plan". For example, if, with respect to a leased employee, the total of the benefits provided under a leasing organization's qualified plan that are treated as provided under a separate qualified plan of the recipient and the benefits provided under a plan actually maintained by the recipient exceed the applicable section 415 limits, the plan actually maintained by the recipient will be treated as failing to satisfy section 415.

(4) *Example.* The provisions of this paragraph may be illustrated by the following example:

Example. Individual A is an employee of Leasing Organization X. X leases A to Company Y under an agreement. A performs services for Y on a substantially full-time basis for a period of more than one year. X maintains a qualified defined contribution plan that is not a safe-harbor plan. Y maintains a qualified defined contribution plan and pursuant to section 414 (n), Y must treat A as its employee. Y determines that 95 percent of A's total compensation received from or on behalf of X is attributable to the performance of services for Y. Based on the amount of A's compensation attributable to A's performance of services for Y, A is not a highly compensated employee of Y. As a result of A not participating in Y's qualified plan, Y's qualified plan does not satisfy the coverage requirements of section 410(b). For purposes of determining the contributions of benefits that Y must provide under its plan on behalf of A in order for Y's plan to satisfy section 410(b) and 401(a)(4), Y may treat 95 percent of the contributions (including employee contributions) and forfeitures on behalf of A under X's plan, as being provided under a separate plan maintained by Y. If the contributions and forfeitures treated as provided to A under a separate plan maintained by Y are comparable to the contributions and forfeitures provided to Y's employees under Y's plan, then Y's plan may satisfy section 410(b) and 401(a)(4) even though A is provided with no additional contributions of forfeitures under Y's qualified plan.

(c) *Deductions.* Compensation (as defined for purposes of section 404) of a leased employee attributable to services performed for a recipient is considered compensation for purposes of determining the recipient's deduction under section 404. The deduction for contributions shall be available, however, only to the organization that actually made the contribution. Therefore, even though contributions by the leasing organization that are attributable to services performed for the recipient are treated as provided by the recipient, the recipient may not deduct the contributions made by the leasing organization. The leasing organization and the recipient, however, may independently determine their deductions under section 404 with respect to a leased employee even though this results in the same compensation being used by both the leasing organization and the recipient.

(d) *Years of service.* For purposes of both participation and vesting, with respect to a plan of the recipient, the entire period for which an employee or a leased employee has performed servces for the recipient must be taken into account in accordance with section 414(n)(4), including periods of service before the effective date of section 414(n), periods of service during which the individual is covered by a safe-harbor plan (as defined in paragraphs (f) and (g) of this section), periods of service during which the individual is an employee of the recipient, and periods of service during which the individual would be a leased employee but for the requirements of § 1.414(n)–1(b)(4)(ii). The service of an individual who is not an employee of the recipient shall be determined under the rules of the recipient's plan for computing years of service, including any plan rules relating to the break-in-service rules of sections 410(a)(5) and 411(a)(6). For example, if a leased employee began performing services for the recipient on January 1, 1981, the leased employee's service for participation and vesting purposes will be considered to have commenced on January 1, 1981. However, because the individual does not become a leased employee until January 1, 1984 (in the case of a recipient with respect to which section 414(n) applies on January 1, 1984), such leased employee need not in any case begin to participate in the plan until January 1, 1984. Therefore, section 414(n) does not require the recipient to provide retroactive benefits for the leased employee for years of service prior to the effective date of section 414(n).

(e) *Coverage precluded for part-time individuals*—(1) *General rule.* Any individual who is not a leased employee because such individual has not met the initial service requirement of § 1.414(n)–1(b)(4)(ii), may not be treated as a leased employee of the recipient. Further, even though an individual has satisfied the initial service requirement of such paragraph, such an individual may not be treated as a leased employee of the recipient in any nonqualifying year (as defined in § 1.414(n)–(b)(13)).

(2) *Inadvertent coverage.* In a case where a recipient's plan inadvertently covers an individual who would be a leased employee but for the fact that such individual has not met the service requirement of § 1.414(n)–1(b)(4)(ii), or who would be a leased employee at the time of coverage but for the fact that the coverage occurs during a nonqualifying year, the recipient's plan will not be denied qualification merely becaue it covered a nonemployee.

(f) *Special rules for services performed after December 31, 1986*—(1) *Safe-harbor plan.* Except as otherwise provided, the rules of section 414(n) shall apply to a leased employee with respect to service provided by the leased employee as an employee of the leasing organization if the requirements of this paragraph (f)(1) are met with respect to contributions and benefits provided by the leasing organization for such leased employee as an employee of the leasing organization. In order for the requirements of this paragraph (f)(1) to be met, the leased employee must be covered by a safe-harbor plan, i.e., a qualified money purchase pension plan maintained by the leasing organization that provides the following:

(i) Except as provided in paragraph (f)(2) of this section, each employee of the leasing organization must be a plan participant on the later of the date such employee first becomes an employee of the leasing organization, or the effective date of this paragraph (f), whether or not such employee is a leased employee on that date.

(ii) Contributions to the plan on behalf of all participants must have always been and must currently be at a rate not less than 10 percent of the employee's compensation (as defined in section 414(q)(7)), whether or not such compensation is attributable to the performance of services for a recipient, whether or not such employee is an employee of the leasing organization on any specified date during the year, and regardless of the number of hours of service performed by the employee for the leasing organization. The requirement of this paragraph (f)(1)(ii) is deemed satisfied with respect to periods prior to the effective date of this

paragraph (f) if, for such periods, the requirements of paragraph (g) are satisfied. The requirement of this paragraph (f)(1)(ii) is not satisfied if either the contribution rate is reduced due to integration or any other factor below 10 percent or contributions to the plan are not made within the period provided by section 412(c)(10). Contributions must be made for all compensation without regard to any age or service requirement.

(iii) An employee's rights to, or derived from, employer contributions under the plan must be immediately nonforeitable in accordance with section 411(a). In addition, an employee's rights to, or derived from, employer contributions must be disregarded for purposes of applying section 411(a) to other contributions or benefits. The requirement or this paragraph (f)(1)(iii) is not satisfied if righs are conditioned in any manner not permitted by section 411(a) (without regard to section 411(a)(3)) with regard to amounts required to be nonforfeitable under such section, including requirements relating to either completion of a year of service or employment on a speicific date.

(iv) A safe-harbor plan must be a qualified plan pursuant to section 401(a) and, therefore, must satisfy the coverage rules of section 410(b) and the nondiscrimation rules of section 401(a)(4), taking into account all employees of the leasing organization, including employees leased to recipients. A safe-harbor plan maintained by the leasing organization must take into consideration, for purposes of section 401(a), all of the leased employee's service for the leasing organization as an employee of the leasing organization (including periods during which the employee was leased by the leasing organization to a recipient) and all compensation with respect to such services of the leased employees.

(2) *Exceptions to coverage requirements.* All employees of a leasing organization must be participants in a safe-harbor plan maintained by the leasing organization other than (i) employees who during the plan year perform substantially all of their services for the leasing organization (and not for recipients), and (ii) employees whose compensation (as deafined in section 414(q)(7)) from the leasing organization is less than $1,000 during the plan year and during each of the three prior plan years. (Employees described in paragraphs (f)(2)(i) and (f)(2)(ii) of this section may be required to be participants in the safe-harbor plan or another plan of the leasing organization under another section of Subchapter D (such as section 410).) For purposes of this paragraph (f)(2), an employee is not considered to perform substantially all of his services for the leasing organization (and not for recipients) during a plan year if during such year more than 15 percent of such employee's total service (based on hours of service, as defined in 29 CFR § 2530.200b–2) with respect to the leasing organization is either performed on the premises of one or more recipients or is performed for one or more recipients. Services performed for a leasing organization that are necessary to support the work of other individuals for recipients are considered services performed for recipients. An example of services that are not performed for any recipient is services performed to develop advertising for the leasing organization.

(3) *Application of section 414(n) to a leased employee notwithstanding the existence of a safe-harbor plan.* (i) Notwithstanding anything in this paragraph (f) to the contrary, the rules of section 414(n) (other than subsection (n)(5) shall apply to a leased employee if such leased employee is covered under any qualified plan of the recipient or if any qualified plan of the recipient relies on the participation of the leased employee in a safe-harbor plan in order to satisfy the requirements of section 410(b).

(ii) Notwithstanding anything in this paragraph (f) to the contrary, the rules of section 414(n) (other than subsection (n)(5)) shall apply, with respect to § 1.414(n)–3(a) (5) and (8), to a leased employee who has an accrued benefit under any qualified plan of the recipient.

(4) *Application of section 414(n) to a leased employee notwithstanding the existence of a safe-harbor plan where a significant percentage of recipient's workforce is comprised of leased individuals.* (i) Notwithstanding anything in this paragraph (f) to the contrary, the rules of section 414(n) (other than subsection (n)(5)) shall apply to a leased employee if leased individuals constitute more than 20 percent of the recipient's nonhighly compensated workforce for the plan year of a plan maintained by the recipient.

(ii) *Nonhighly compensated workforce.* The term "nonhighly compensated workforce" means the total number of individuals (other than highly compensated employees) who are either (A) employees of the recipient or (B) leased individuals.

(iii) *Highly compensated employee.* The term "highly compensated employee" has the meaning given such term by section 414(q).

(iv) *Leased individual.* For purposes of this paragraph (f)(4), the term "leased individual" means an individual who (A) during the plan year of a plan maintained by a recipient performs any services for a recipient other than as an employee of the recipient and (B) for such plan year would (without regard to this paragraph (f)) be a leased employee with respect to the recipient if all services performed by such individual for the recipient during the plan year and all prior years were performed other than in the capacity of an employee of the recipient. The fact that an individual may also perform services as an employee of the recipient during the plan year or a prior year does not affect his status as a leased individual.

(v) *Employee of the recipient.* For purposes of paragraph (f)(4)(ii) of this section, the term "employee of the recipient" means any individual who (A) during the plan year of a plan maintained by a recipient performs services for the recipient only in the capacity of an employee of the recipient, and (B) would be a leased individual if any of such services were performed other than in the capacity of an employee.

(vi) *Recipient.* For purposes of this paragraph (f)(4), the term "recipient" has the same meaning as in paragraphs (b)(2) and (b)(6) of § 1.414(n)–1, except that "leased individuals" is substituted for "leased employee".

(vii) *Inapplicability of certain paragraphs of § 1.414 (o)–1 to this paragraph (f)(4).* The provisions of paragraph (f)(4) of this section are to be applied without regard to the provisions of paragraphs (b), (c), and (g) of § 1.414(o)–1. Therefore, for purposes of paragraphs (f)(4)(iv) and (f)(4)(v) of this section, and notwithstanding anything to the contrary in paragraphs (b), (c), and (g) of § 1.414(o)–1, services performed by an individual other than as an employee of a recipient are not considered services performed by an employee of a recipient.

(5) *Effective dates*—(i) In general, the safe-harbor plan provisions of this paragraph (f) apply to services performed after December 31, 1986.

(ii) If a leasing organization has a safe-harbor plan that satisfies paragraph (g) of this section for a plan year beginning prior to January 1, 1987, the following rules apply. The plan must satisfy paragraph (g) of this section for plan years beginning prior to January 1, 1987. The plan must be amended by the

end of the first plan year beginning after December 31, 1988, effective for all plan years beginning after December 31, 1986, to comply with the requirements of paragraph (f) of this section. Prior to any amendment to comply with paragraph (f) of this section, the plan must in operation comply with paragraph (f) of this section for all plan years beginning after December 31, 1986.

(iii) Paragraph (f)(5)(ii) of this section shall not apply with respect to a leasing organization with a safe-harbor plan (in accordance with paragraph (g) of this section) on [Insert date this document is filed with the Federal Register] if the leasing organization, after such date, changes the plan year of its safe-harbor plan or establishes another plan so that the period that it is subject to paragraph (g) of this section would be longer.

(iv) Notwithstanding paragraph (f)(5)(ii) of this section, paragraph (f)(4) of this section applies to a recipient for plan years beginning after December 31, 1986. If a recipient maintains plans with more than one plan year, paragraph (f)(4) applies to the recipient as of the plan year beginning closest to and after December 31, 1986.

(v) For safe-harbor plan provisions that apply to services performed before the effective date of this paragraph (f), see paragraph (g) of this section.

(g) *Special rules for services performed before January 1, 1987*—(1) *Safe-harbor plan.* Except as otherwise provided, the rules of section 414(n) shall not apply to a leased employee with respect to service provided by the leased employee to a recipient as an employee of the leasing organization if the requirements of this paragraph (g)(1) are met with respect to contributions and benefits provided by the leasing organization for such leased employee as an employee of the leasing organization. In order for the requirements of this paragraph (g)(1) to be met, the leased employee must be covered by a safe-habor plan, i.e., a qualified money purchase pension plan maintained by the leasing organization that provides the following:

(i) The leased employee must become a plan participant on and after the start of the first 12-month period used to determine if the employee is a leased employee under section 414(n) with respect to the recipient.

(ii) Contributions to the plan on behalf of the leased employee must have always been (on and after the effective date of this paragraph (g)) and must currently be at a rate not less than 7½ percent of the leased employee's compensation (as defined in § 1.415–2(d)), whether or not such compensation is attributable to the performance of services for a recipient, whether or not such employee is an employee of the leasing organization on any specified date during the year, and regardless of the number of hours of service performed by the employee for the leasing organization. The requirement of this paragraph (g)(1)(ii) is not satisfied if either the contribution rate is reduced due to integration or any other factor below 7½ percent or contributions to the plan are not made within the period provided by section 412(c)(10). Contributions must be made for all compensation without regard to any age or service requirement.

(iii) The leased employee's rights to, or derived from, employer contributions under the plan must be immediately nonforfeitable in accordance with section 411(a). In addition, the leased employee's rights to, or derived from, such employer contributions must be disregarded for purposes of applying section 411(a) to other contributions or benefits. The requirements of this paragraph (g)(1)(iii) is not satisfied if rights are conditioned in any manner not permitted by section 411(a) (without regard to section 411(a)(3)) with regard to amounts required to be vested under such section, including requirements relating to either completion of a year of service or employment on a specific date.

(iv) A safe-harbor plan must be a qualified plan pursuant to section 401(a) and, therefore, must satisfy the coverage rules of section 410(b) and the nondiscrimination rules of section 401(a)(4), taking into account all employees of the leasing organization, including employees leased to recipients. A safe-harbor plan maintained by the leasing organization must take into consideration, for purposes of section 401(a), all of the leased employee's service for the leasing organization as an employee of the leasing organization (including periods during which the employee was leased by the leasing organization to a recipient) and all compensation with respect to such services of the leased employee.

(2) *Coverage of leased employees.* A safe-harbor plan maintained by a leasing organization need not cover every employee of the leasing organization or every leased employee who is an employee of the leasing organization. (Any recipient who utilizes the services of a leased employee not covered by a safe-harbor plan, however, must treat such employee as the recipient's employee for purposes of the employee benefit requirements listed in § 1.414(n)–3(a).)

(3) *Application of section 414(n) to a leased employee notwithstanding the existence of a safe-harbor plan*—(i) Notwithstanding anything in this paragraph (g) to the contrary, the rules of section 414(n) (other than subsection (n)(5)) shall apply to a leased employee if such leased employee is covered under any qualified plan of the recipient or if any qualified plan of the recipient relies on the participation of the leased employee in a safe-harbor plan in order to satisfy the requirements of section 410(b).

(ii) Notwithstanding anything in this paragraph (g) to the contrary, the rules of section 414(n) (other than subsection (n)(5)) shall apply, with respect to § 1.414(n)–3(a) (5) and (8), to a leased employee who has an accrued benefit under any qualified plan of the recipient.

(4) *Effective dates.* (i) In general, the safe-harbor plan provisions of this paragraph (g) apply to services performed after the effective date of section 414(n) (see paragraph (c) of § 1.414(n)–3). The safe harbor plan provisions of this paragraph (g) shall cease to apply as of the effective date of the safe-harbor plan provisions of paragraph (f) of this section.

(ii) In a case where a leasing organization adopts a safe-harbor plan (in accordance with this paragraph (g)) by the end of its first plan year beginning after December 31, 1983, that is effective as of the beginning of such plan year and such plan year begins before 1985, then, with respect to the leasing organization, section 414(n) will not apply to a recipient for any interim period between the beginning of the recipient's first plan year beginning in the recipient's first tax year beginning after December 31, 1983, and the beginning of such plan year of the leasing organization.

(iii) Paragraph (g)(4)(ii) of this section shall not apply to an individual if, during any interim period, the recipient covers such individual under a qualified plan and such individual would be a leased employee but for paragraph (g)(4)(ii) of this section.

(iv) Paragraph (g)(4)(ii) of this section shall not apply to an individual with respect to paragraphs (a)(5) or (a)(8) of § 1.414(n)–3 if such individual would be a leased employee but for paragraph (g)(4)(ii) of this section and such individual had, during or prior to any interim period, an accrued benefit under a qualified plan of the recipient.

§ 1.414(n)–3 Employee benefit requirements, recordkeeping, and effective dates.

(a) *In general.* Except as otherwise provided, a leased employee shall be treated as an employee of the recipient for purposes of the following employee benefit requirements:

(1) Section 401(a) (relating to the exclusive benefit rule);

(2) Sections 401(a)(3) and 410 (relating to minimum participation requirements);

(3) Section 401(a)(4) (requiring that contributions or benefits do not discriminate in favor of employees who are officers, shareholders, or highly compensated);

(4) Sections 401(a)(7) and 411 (relating to minimum vesting standards);

(5) Sections 401(a)(16) and 415 (relating to limitations on contributions and benefits);

(6) Section 404 (relating to deductions for contributions);

(7) Section 408(k) (relating to simplified employee pensions); and

(8) Section 416 (relating to top-heavy plans).

(b) *Recordkeeping requirements*—(1) *General rule.* Except as othewise provided in this paragraph (b), a recipient must maintain employment records of sufficient detail to determine whether, and to what extent, individuals who provide services to the recipient are leased employees.

(2) *Recordkeeping exception*—(i) *In general.* A recipient shall be excepted from the recordkeeping requirements described in paragraph (b)(1) of this section in a plan year if, for such plan year and each previous plan year commencing with the first plan year beginning on or after the date section 414(n) is effective with respect to the recipient, the requirements of this paragraph (b)(2) are satisfied. If a recipient maintains plans with more than one plan year, the first plan year beginning on or after the date section 414(n) is effective with respect to the recipient shall be the plan year commencing closest to the date section 414(n) is effective with respect to the recipient. Should the recipient subsequently amend such plan year or change to a different plan year for purposes of this paragraph (b)(2), rules similar to those provided under 29 CFR 2530.203–2(c)(1) shall apply.

(ii) *Exception requirements.* If the following three conditions are satisfied, a recipient will have satisfied the requirements of this paragraph (b)(2).

(A) All of the recipient's qualified plans specifically provide that leased employees are not eligible to participate in such plans.

(B) No qualified plan of the recipient is a top-heavy plan as defined in section 416 (g).

(C) The number of leased persons providing services to the recipient during the recipient's plan year is less than five percent of the number of employees (excluding leased persons and highly compensated employees within the meaning of section 414(q)) covered by a qualified plan of the recipient at any time during such plan year. An individual is a leased person for purposes of this paragraph (b)(2)(ii)(C) if—

(*1*) During the plan year the individual performs any services for a recipient other than as an employee of the recipient, with respect to which the requirements of § 1.414(n)–1 (b)(4)(i) and (b)(4)(iii) are satisfied,

(*2*) The individual is credited with at least 1500 hours of service for the recipient during the plan year, including service performed as an employee of the recipient and in any other capacity, and

(*3*) The individual either is not covered under a qualified plan of the recipient as an employee of the recipient at any time during such plan year or the individual performs at least 501 hours of service for the recipient during the plan year other than as an employee of the recipient.

For purposes of this paragraph (b)(2)(ii)(C), the term "hour of service" has the same meaning as the term "hour of service" provided by 29 CFR 2530.200b–2 under the general method of crediting service for an employee. If one of the equivalencies set forth in 29 CFR 2530.200b–3 is used with respect to an individual for crediting hours of service, such equivalency must be used on a reasonable and consistent basis and the 1500-hour and 500-hour requirements must be adjusted accordingly (as under § 1.414(n)–1(b)(10)(iii)). With respect to determining whether an individual satisfies the 1500-hour requirement, reasonable approximations may be made. For example, a recipient generally need not check whether an individual who worked less than 1500 hours at one division also worked at another geographically separate division, unless such checking would be reasonable under the circumstances (such as in the case where the recipient transfers the individual). Also, a recipient may, in determining whether an individual satisfies the 1500-hour requirement, rely on records maintained by the leasing organization or leasing organizations providing the services of such individual, except where the recipient has reason to believe that such records are not accurate. A recipient must add together all service performed for the recipient by the individual as an employee of the recipient and through all leasing organizations. In addition, if with respect to a recipient, the determination of the precise number of leased persons would be unreasonably burdensome due to the large numbers involved, the recipient may rely on a statistically valid sample performed by an independent third party to estimate the number of leased persons. The Commissioner may provide additional methods for determining the number of leased persons with respect to a recipient.

(3) *An individual's entitlement to treatment as a leased employee.* (i) At the option of the recipient, individuals will not be entitled to treatment as leased employees unless such individuals provide to the recipient satisfactory evidence of entitlement to such treatment.

(ii) This paragraph (b)(3) shall apply only with respect to an individual's period of service with a recipient prior to and during those plan years of the recipient for which the recipient qualified for the recordkeeping exception described in paragraph (b)(2) of this section.

(c) *Section 414(n) effective dates*—(1) *In general.* The provisions of section 414(n) are effective for tax years of recipients beginning after December 31, 1983. If persons included in a recipient have different tax years, the provisions of section 414(n) are effective with respect to the entire recipient for the tax year beginning closest to January 1, 1984. Therefore, the provisions of section 414(n) apply to plan years beginning during and after such first tax year of a recipient beginning after December 31, 1983. If a recipient maintains plans with more than one plan year, the provisions of section 414(n) apply to the recipient as of the plan year beginning closest to the first day of the first tax year of the recipient beginning after December 31, 1983.

(2) *Certain delayed effective dates.* Paragraphs (a)(1)(i) and (a)(1)(ii) of § 1.414(n)–2 (relating to language required in a recipient's plan regarding leased employees) and paragraph (b)(2)(ii)(A) of this section (relating to certain recordkeeping exception requirements), shall not apply until the first plan year of a recipient beginning after December 31, 1988. Paragraph (b)(2)(ii)(C) of this section shall not apply until the first plan year beginning after December 31, 1986. The first plan year of a recipient shall be determined in the same manner as under paragraph (c)(1) of this section.

(3) *Special safe-harbor plan effective dates.* For special effective dates relating to safe-harbor plans, see paragraphs (f)(5) and (g)(4) of § 1.414(n)–2.

§ 1.414(n)–4 Application of section 414(o) to section 414(n).

Section 414(o) provides that the Secretary shall prescribe such regulations (which may provide rules in addition to the rules contained in section 414(n)) as may be necessary to prevent the avoidance of any employee benefit requirement listed in section 414(n)(3) through the use of separate organizations, employee leasing, or other arrangements. Accordingly, the regulations under section 414(n) are promulgated, in part, pursuant to the authority granted by section 414(o). For additional rules that may relate to section 414(n), see section 414(o) and the regulations thereunder.

§ 1.414(o)–1 Avoidance of employee benefit requirements through the use of separate organizations, employee leasing, or other arrangements.

(a) *In general.* (1) Pursuant to section 414(o), this section provides rules, in addition to the rules contained in sections 414(m) and 414(n) and the regulations thereunder, to prevent the avoidance of any employee benefit requirement listed in either § 1.414(m)–3 or § 1.414(n)–3, through the use of separate organizations, employee leasing, or other arrangements.

(2) For the definition of the terms "person" and "leased employee", see § 1.414(n)–1(b). For the definition of the term "organization", see § 1.414(m)–5(a)(2). For the definition of the terms "management functions" and "management activities or services", see § 1.414(m)–5(c).

(3) For purposes of this section, the term "plan" means a stock bonus, pension, or profit-sharing plan qualified under section 401(a) or a simplified employee pension under section 408(k).

(4) For purposes of this section, the term "employee" includes a "self-employed individual" as defined in section 401(c)(1).

(5) For purposes of this section, the term "maintained", when used in the context of a plan maintained by any person, means "maintained at any time".

(6) For purposes of this section, services performed for a person other than as an employee of such person means services performed directly or indirectly for such person.

(b) *Services performed by leased owners*—(1) *In general.* (i) If an individual is a leased owner with respect to a recipient, then for purposes of determining whether any qualified plan actually maintained by the recipient and whether any qualified plan maintained by a leasing organization in which the leased owner is a participant (or in which the leased owner has or had an accrued benefit) satisfies the employee benefit requirements of section 1.414(n)–3(a) (except for paragraph (a)(6) of that section) for a plan year, the leased owner's interest in the leasing organization's qualified plan attributable to services performed by the leased owner for the recipient is to be treated as provided under a separate qualified plan maintained by the recipient covering only the leased owner and the leased owner is to be treated as an employee of the recipient. If a separate qualified plan is treated as maintained by the recipient with respect to a leased owner and such leased owner also participates in a qualified plan actually maintained by the recipient, the leased owner's interest in the leasing organization's qualified plan attributable to the leased owner's performance of services for the recipient that is treated as provided to the leased owner under a separate qualified plan of the recipient is to be treated as provided to the leased owner under the qualified plan actually maintained by the recipient for purposes of determining whether such qualified plan satisfies the applicable employee benefit requirements. If either the separate qualified plan for the leased owner that is treated as maintained by the recipient or any qualified plan that is actually maintained by the recipient fails to satisfy any of the applicable employee benefit requirements, then except as provided in paragraphs (b)(1)(ii) and (b)(1)(iii) of this section, the following qualified plans shall be treated as not satisfying such requirements: any qualified plan actually maintained by the recipient in which the leased owner is a participant (or has or had an accrued benefit) and any qualified plan that is actually maintained by a leasing organization in which the leased owner has an interest that is attributable to the leased owner's performance of services for the recipient.

(ii) The Commissioner will not apply paragraph (b)(1)(i) of this section so as to disqualify a plan actually maintained by a recipient unless the Commissioner determines that, taking into account all the facts and circumstances, the disqualification of a leasing organization's plan would be ineffective as a means of securing compliance with the applicable employee benefit requirements. For example, it may be appropriate to disqualify the recipient's plan where a leasing organization's plan was terminated or substantial assets were removed therefrom in a year for which the statute of limitations has run with respect to the employer, employee, or trust.

(iii) If pursuant to paragraph (b)(1)(i) of this section, more than one leasing organization plan is subject to disqualification and at least one of the plans would not be disqualified if another plan or plans were disqualified first, all affected plan sponsors may, by agreement, elect the plan or plans subject to disqualification, provided that such election is not inconsistent with the purposes of this paragraph (b), such as where the plan or plans elected were terminated or substantial assets were removed therefrom in a year for which the statute of limitations has run with respect to the employer, employee, or trust. In the absence of such an election, the Commissioner, taking into account all the facts and circumstances, shall have the discretion to determine which plan or plans shall be disqualified.

(2) *Leased owner* (i) For purposes of this paragraph (b), an individual is a "leased owner" with respect to a recipient if during the plan year of a plan maintained by a leasing organization the individual (A) performs any services for a recipient other than as an employee of the recipient and (B) is, at the time such services are performed, a five-percent owner of the recipient. The fact that an individual may also perform services as an employee of the recipient does not affect his status as a leased owner. If an individual becomes a leased owner with respect to a recipient, such individual is from that point on always to be considered a leased owner with respect to the recipient, notwithstanding anything in this paragraph (b) to the contrary, even if subsequently all services performed by the individual for the recipient are performed as an employee of the recipient.

(ii) Except as provided in paragraph (b)(2)(iii) of this section, and notwithstanding the first sentence of paragraph (b)(2)(i) of this section to the contrary, an individual is not a leased owner with respect to a recipient for purposes of a plan year of a plan maintained by a leasing organization if, during each calendar year containing at least one day of such plan year, less than 25 percent of his total hours actually worked for substantial compensation are for all recipients with respect to which he is a leased owner (but for the application of this paragraph (b)(2)(ii)) and less than 25 percent of his total compensation is derived from

performing services for all such recipients. For purposes of this paragraph (b)(2)(ii), performing services for the recipient includes services performed as an employee of the recipient and in any other capacity. For purposes of this paragraph (b)(2)(ii), the term "compensation" means (A) with respect to services performed as a common-law employee, compensation reportable on Form W–2, and (B) with respect to services performed other than as a common-law employee, earned income as defined in section 401(c)(2). See section 414(s) for the definition of "compensation" for years beginning after December 31, 1986.

(iii) Paragraph (b)(2)(ii) of this section does not apply to an individual who (A) is a leased owner with respect to a recipient pursuant to the application of the first sentence of paragraph (b)(2)(i) of this section, and (B) performs professional services (as defined in § 1.414(m)–1(c)) for the recipient, whether or not as an employee of the recipient, during the plan year of the plan maintained by the leasing organization, of the same type as the professional services performed by the recipient for third parties.

(3) *Recipient.* For purposes of this paragraph (b), the term "recipient" has the same meaning as in paragraphs (b)(2) and (b)(6) of § 1.414(n)–1, except that "leased owner" is substituted for "leased employee".

(4) *Leasing organization.* For purposes of this paragraph (b), the term "leasing organization" has the same meaning as in § 1.414(n)–1(b)(1), except that "leased owner" is substituted for "leased employee" and that "or provided" is added after "provides".

(5) *Five-percent owner.* For purposes of this paragraph (b), an individual is a five-percent owner of a recipient if such individual is a 5-percent owner (as defined in section 416(i)) of any person included in the recipient.

(6) *Contributions, benefit, etc., provided to a leased owner.* For purposes of this paragraph (b), a leased owner's interest in a leasing organization (as defined in § 1.414(n)–2(b)(1)(ii) and in a leasing organization's qualified plan (as defined in § 1.414(n)–2(b)(1)(i)), to the extent attributable to services for the recipient by the leased owner, is, for purposes of the applicable employee benefit requirements, treated as provided by the recipient or under a plan of the recipient. For rules relating to the application of this requirement, see paragraph (b)(2) of § 1.414(n)–2.

(7) *Effect on employee rules.* To the extent that a leased owner performs services for a recipient other than in the capacity of an employee, a leased owner is not an employee of the recipient and may not be actually covered by a plan of the recipient. Such leased owner may, however, qualify as a leased employee under section 414(n) and the regulations thereunder.

(c) *Management functions performed by leased managers*—(1) *In general.* (i) If in a calendar year more than 50 percent of the management functions of a recipient are performed by leased managers, then for purposes of determining whether any qualified plan actually maintained by the recipient and whether any qualified plan maintained by a leasing organization in which one or more leased managers is a participant (or in which one or more leased managers has or had an accrued benefit) satisfies the employee benefit requirements of section 1.414(n)–3(a) (except for paragraph (a)(6) of that section) for a plan year, the leased manager's interest in the leasing organization's qualified plan attributable to services performed by the leased manager for the recipient is to be treated as provided under a separate qualified plan maintained by the recipient covering only the leased manager and the leased manager is to be treated as an employee of the recipient. If a separate qualified plan is treated as maintained by the recipient with respect to a leased manager and the leased manager also participates in a qualified plan actually maintained by the recipient, the leased manager's interest in the leasing organization's qualified plan attributable to the leased manager's performance of services for the recipient that is treated as provided to the leased manager under a separate qualified plan of the recipient is to be treated as provided to the leased manager under the qualified plan actually maintained by the recipient for purposes of determining whether such qualified plan satisfies the applicable employee benefit requirements. If either the separage qualified plan for the leased manager that is treated as maintained by the recipient or any qualified plan that is actually maintained by the recipient fails to satisfy any of the applicable employee benefit requirements, then except as provided in paragraphs (c)(1)(ii) and (c)(a1)(iii) of this section, the following qualified plans shall be treated as not satisfying such requirements: any qualified plan actually maintained by the recipient in which the leased manager is a participant (or has or had an accrued benefit) and any qualified plan that is actually maintained by a leasing organization in which the leased manager has an interest that is attributable to the leased manager's performance of services for the recipient.

(ii) The Commissioner will not apply paragraph (c)(1)(i) of this section so as to disqualify a plan actually maintained by a recipient unless the Commissioner determines that, taking into account all the facts and circumstances, the disqualification of a leasing organization's plan would be ineffective as a means of securing compliance with the applicable employee benefit requirements. For example, it may be appropriate to disqualify the recipient's plan where a leasing organization's plan was terminated or substantial assets where removed therefrom in a year for which the statute of limitations has run with respect to the employer, employee, or trust.

(iii) If pursuant to paragraph (c)(1)(i) of this section, more than one leasing organization plan is subject to disqualification, and at least one of the plans would not be disqualified if another plan or plans were disqualified first, all affected plan sponsors may, by agreement, elect the plan or plans subject to disqualification, provided that such election is not inconsistent with the purposes of this paragraph (c), such as where the plan or plans elected were terminated or substantial assets were removed therefrom in a year for which the statute of limitations has run with respect to the employer, employee, or trust. In the absence of such an election, the Commissioner, taking into account all the facts and circumstances, shall have the discretion to determine which plan or plans shall be disqualified.

(2) *Leased manager.* For purposes of this paragraph (c), the term "leased manager" means an individual who during the calendar year

(i) Performs any services for a recipient other than as an employee of the recipient,

(ii) Performs a significant amount of management activities or services for the recipient, including management functions performed as an employee of the recipient and in any other capacity, and

(iii) Is credited with at least 1,000 hours of service for the recipient, including services performed as an employee of the recipient and in any other capacity.

For rules relating to hours of service, see § 1.414(n)–1(b)(10)(iii). The fact that an individual may also perform services as an employee of the recipient does not affect his status as a leased manager. The fact that the only management activities or services performed by an individual may be performed as an employee of the recipient does not affect

his status as a leased manager. An individual performs a significant amount of management activities or services for a recipient if, during the calendar year, at least 15 percent of the individual's hours of service for the recipient are attributable to the performance of management activities or services. If an individual becomes a leased manager with respect to a recipient, such individual is from that point on always to be considered a leased manager with respect to the recipient, notwithstanding anything in this paragraph (b) to the contrary, even if subsequently all services performed by the individual for the recipient are performed as an employee of the recipient.

(3) *Recipient.* For purposes of this paragraph (c), the term "recipient" has the same meaning as in paragraphs (b)(2) and (b)(6) of § 1.414(n)–1, except that "leased manager" is substituted for "leased employee."

(4) *Leasing organization.* For purposes of this paragraph (c), the term "leasing organization" has the same meaning as in § 1.414(n)–1(b)(1), except that "leased manager" is substituted for "leased employee" and that "or provided" is added after "provides".

(5) *Contributions, benefits, etc., provided to a leased manager.* For purposes of this paragraph (c), a leased manager's interest in a leasing organization (as defined in § 1.414(n)–2(b)(1)(i)) and in a leasing organization's qualified plan (as defined in § 1.414(n)–2(b)(1)(i)), to the extent attributable to services performed for the recipient by the leased manager, is, for purposes of the applicable employee benefit requirements, treated as provided by the recipient or under a plan of the recipient. For rules relating to the application of this requirement, see paragraph (b)(2) of § 1.414(n)–2.

(6) *Effect on employee rules.* To the extent that a leased manager performs services for a recipient other than in the capacity of an employee, a leased manager is not an employee of the recipient and may not be actually covered by a plan of the recipient. Such leased manager may, however, qualify as a leased employee under section 414(n) and the regulations thereunder.

(7) *More-than-50-percent test.* The more-than-50-percent test of this paragraph (c) is applied by comparing the compensation of employees of the recipient who perform management functions for the recipient to the compensation of the leased managers. For purposes of this paragraph (c)(7), the term "compensation" means:

(i) With respect to services performed as a common-law employee of the recipient or leasing organization, compensation reportable on Form W–2, and

(ii) With respect to services performed other than as a common-law employee of the recipient or leasing organization, earned income as defined in section 401(c)(2).

For purposes of this paragraph (c)(7), the term "compensation" includes only amounts attributable to services performed for the recipient. If a leased manager performs services for the recipient both as an employee of the recipient and other than as an employee of the recipient, an appropriate allocation of compensation is required for purposes of applying the more-than-50-percent test. For purposes of applying the more-than-50-percent test, an employee of the recipient shall be disregarded unless such employee satisfies the requirements of paragraphs (c)(2)(ii) and (c)(2)(iii) of this section.

(8) *Inapplicability of section 414(n) and other paragraphs of § 1.414(o)–1 to this paragraph (c).* The provisions of paragraph (c) of this section are to be applied without regard to the provisions of paragraphs (b) and (g) of this section and the provisions of section 414(n). Therefore, for purposes of paragraphs (c)(2), (c)(6), and (c)(7) of this section, and notwithstanding anything to the contrary in paragraphs (b) and (g) of this section or in section 414(n) and the regulations thereunder, services performed by an individual other than as an employee of a recipient are not considered services performed by an employee of a recipient.

(d) [Reserved]

(e) *Successive organizations in time.* If section 414 (b) or (c) would apply to two or more organizations but for the fact that such organizations exist at different times, rather than concurrently in time, section 414 (b) and (c) shall apply to such organizations as if they existed concurrently in time. Thus, for example, section 415 would apply by aggregating all plans of such organizations.

(f) *Services performed by shared employees*—(1) *In general.* If an individual is a shared employee with respect to certain persons (sharing persons), then for purposes of determining whether any plan maintained by such sharing persons satisfies the employee benefit requirements listed in § 1.414(n)–3(a) (except for paragraph (a)(6) of that section) for any plan year of such plans, the shared employee shall be treated as working exclusively for each sharing person by treating the combined services of the shared employee for all employing persons (as defined in paragraph (f)(2)(i) of this section) as services provided to each sharing person.

(2) *Shared employee.* For purposes of this paragraph (f), an individual is a shared employee with respect to a person if during the plan year of such person's plan—

(i) Such individual performs services as an employee for such person and for one or more other persons (collectively referred to as employing persons) at one or more shared business premises of such employing persons or one or more common locations; and

(ii) The total service performed at such shared premises or locations for the employing person by all individuals (excluding any individual who performs at least 1,000 hours of service for an employing person, performs no services for any other employing person at such shared premises or locations, and is covered by the employing person's plan) who perform services of the same type performed by the individual for the employing person equals or exceeds 1,000 hours of service (determined by adding together the services of all such individuals).

For rules relating to hours of service, see § 1.414(n)–1(b)(10) (iii) and (iv). For purposes of this paragraph (f)(2), the determination of whether services have been performed at a shared business premises or some other common location will generally depend on the facts and circumstances of the situation. Examples of a shared business premises may include common, interconnecting, or adjacent offices on the same or an adjacent floor of an office building.

(3) *Examples.* The provisions of this paragraph may be illustrated by the following examples.

Example (1). Each of five doctors leases an office suite which interconnects with a common reception area. Each doctor is a sole proprietor. The doctors collectively employ five nurses who perform only nursing duties and each of whom is considered to spend one fifth of her time working for each doctor. With respect to each doctor, the total service performed by the five nurses exceeds 1,000 hours of service during the calendar year (which is also the plan year for each doctor's plan). All five of the nurses are shared employees with respect to each of the five doctors.

Example (2). Assume the same facts as in example 1. In addition, assume that the five doctors employ one receptionist who is considered to spend one fifth of her time working for each of the five doctors. The receptionist has 1500 hours of service during the calendar year. No other receptionist is employed by any of the five doctors. Because no doctor received at least 1,000 hours of service from the receptionist during the calendar year, the requirement of paragraph (f)(2)(ii) of this section is not satisfied, and

the receptionist is not a shared employee with respect to any of the five doctors.

(4) *Determination of contributions and benefits.* (i) The amount of any contribution or benefit that is to be made or accrued for a shared employee by each sharing person shall be the lesser of the contribution or benefit determined under paragraphs (f)(4)(ii) and (f)(4)(iii) of this section.

(ii) Multiply the contribution or benefit calculated under the plan as if the shared employee were employed exclusively by that person and received all compensation (i.e., all compensation paid to the shared employee by all of the employing persons) from that person by a fraction, the numerator of which is the amount of compensation paid the shared employee by that person and the denominator of which is the amount of compensation paid the shared employee by all of the sharing persons.

(iii) Multiply the contribution or benefit calculated under the plan as if the shared employee were employed exclusively by that person and received all compensation (i.e., all compensation paid to the shared employee by all of the sharing persons) from that person by a fraction, the numerator of which is the amount of compensation paid the shared employee by that person and the denominator of which is the amount of compensation paid the shared employee by all of the sharing persons. The contribution or benefit determined under the preceding sentence is increased by the contribution or benefit calculated under the plan as if the shared employee received additional compensation equal to the shared employee's proportionate share of noncovered compensation. Noncovered compensation is compensation paid by the sharing person for services at the shared premises or locations to all individuals not covered by the plan who perform services for the sharing person of the same type as those performed by the shared employee. The shared employee's proportionate share of noncovered compensation is determined by multiplying the noncovered compensation by a fraction, the numerator of which is the shared employee's compensation from all employing persons who are not sharing persons and the denominator of which is the compensation from all employing persons who are not sharing persons paid to all shared employees covered by the plan. The contribution or benefit calculated under the plan on the shared employee's proportionate share of noncovered compensation is determined for all purposes (including integration) as if such proportionate share were paid in addition to the compensation paid to the shared employee by all sharing persons.

(iv) For purposes of this paragraph (f), the term "compensation" means compensation determined in a manner consistent with the definition of compensation under the sharing person's plan and with section 401(a)(4). For purposes of this paragraph (f), compensation includes earned income as defined in section 401(c)(2).

(5) *Shared leased employees.* The requirements of this paragraph (f) also apply if two or more persons share the services of a leased employee. For purposes of determining whether an individual is a leased employee, all persons who would be employing persons if such individual performed his services as an employee of such persons are treated as a single recipient.

(g) *Inside corporate director*—(1) *In general.* (i) To the extent that contributions, forfeitures and benefits of an inside director under a qualified plan maintained by the inside director are attributable to services performed by the inside director for the recipient as a director, then for purposes of determining whether any qualified plan actually maintained by the recipient and whether any qualified plan maintained by the inside director in which the inside director is a participant (or in which the inside director has or had an accrued benefit) satisfies the employee benefit requirements of section 1.414(n)-3(a) (except for paragraph (a)(6) of that section) for a plan year, the inside director's interest in the inside director's qualified plan attributable to services performed by the inside director for the recipient is to be treated as provided under a separate qualified plan maintained by the recipient covering only the inside director and the inside director is to be treated as an employee of the recipient. If a separate qualified plan is treated as maintained by the recipient with respect to an inside director and the inside director also participates in a qualified plan actually maintained by the recipient, the inside director's interest in the inside director's qualified plan attributable to the inside director's performance of services for the recipient that is treated as provided to the inside director under a separate qualified plan of the recipient is to be treated as provided to the inside director under the qualified plan actually maintained by the recipient for purposes of determining whether such qualified plan satisfies the applicable employee benefit requirements. If either the separate qualified plan for the inside director that is treated as maintained by the recipient or any qualified plan that is actually maintained by the recipient fails to satisfy any of the applicable employee benefit requirements, then except as provided in paragraphs (g)(1)(ii) and (g)(1)(iii) of this section, the following qualified plans shall be treated as not satisfying such requirements: any qualified plan actually maintained by the recipient in which the inside director is a participant (or has or had an accrued benefit) and any qualified plan that is actually maintained by the inside director in which the inside director has an interest that is attributable to the inside director's performance of services for the recipient.

(ii) The Commissioner will not apply paragraph (g)(1)(i) of this section so as to disqualify a plan actually maintained by a recipient unless the Commissioner determines that, taking into account all the facts and circumstances, the disqualification of an inside director's plan would be ineffective as a means of securing compliance with the applicable employee benefit requirements. For example, it may be appropriate to disqualify the recipient's plan where an inside director's plan was terminated or substantial assets were removed therefrom in a year for which the statute of limitations has run with respect to the employer, employee, or trust.

(iii) If pursuant to this paragraph (g), more than one inside director plan is subject to disqualification, and at least one of the plans would not be disqualified if another plan or plans were disqualified first, all affected inside directors may, by agreement, elect the plan or plans subject to disqualification, provided that such election is not inconsistent with the purposes of this paragraph (g), such as where the plan or plans elected were terminated or substantial assets were removed therefrom in a year for which the statute of limitations has run with respect to the employer, employee, or trust. In the absence such an election, the Commissioner, taking into account all the facts and circumstances, shall have the discretion to determine which plan or plans shall be disqualified.

(2) *Inside director.* For purposes of this paragraph (g), the term "inside director" means any individual who is both an employee (determined after application of section 414(n) and paragraphs (b) and (c) of this section) of any person included in the recipient and a director of any corporation included in the recipient, regardless of whether such an individual is an employee (determined after application of section 414(n) and paragraphs (b) and (c) of this

section) and a director with respect to the same corporation. If an individual becomes an inside director with respect to the recipient, such individual is from that point on always to be considered an inside director, notwithstanding anything in this paragraph (g) to the contrary, even if such individual ceases to be an employee (determined after application of section 414(n) and paragraphs (b) and (c) of this section) or director of any person included in the recipient.

(3) *Recipient.* For purposes of this paragraph (g), the term "recipient" has the same meaning as in paragraphs (b)(2) and (b)(6) of § 1.414(n)–1, except that "inside director" is substituted for "leased employee".

(4) *Contributions, benefits, etc., provided to an inside director.* For purposes of this paragraph (g), an inside director's interest in the directorship (an interest in a directorship is defined like an interest in a leasing organization, which is defined in § 1.414(n)–2(n)(1)(i)) and in the inside director's qualified plan (as defined in § 1.414(n)–2(b)(1)(i)), to the extent attributable to services by the inside director for the recipient as a director, are, for purposes of the applicable employee benefit requirements, treated as provided by the recipient or under a plan of the recipient. For rules relating to the application of this requirement, see paragraph (b)(2) of § 1.414(n)–2.

(5) *Effect on employee rules.* To the extent that an inside director performs services for a recipient as a director, an inside director is not an employee of the recipient and may not be actually covered by a plan of the recipient. Such inside director may, however, qualify as a leased employee under section 414(n) and the regulations thereunder.

(h) *Certain five-percent owners of service organizations*—(1) *In general.* In the case of an employee who is (or was) a five-percent owner of an employer, all contributions, forfeitures, and benefits made or accrued with respect to such employee under any plan maintained by such employer shall, for purposes of section 415, be aggregated with all contributions, forfeitures, and benefits made or accrued with respect to such employee under any plan maintained by any other current (or former) employer with respect to which such employee is (or was) a five-percent owner. For purposes of this paragraph (h), the term "employer" includes only service organizations as defined in § 1.414(m)–2(f)(2). This paragraph shall be applied after the application of section 414(n) and paragraphs (b), (c), (e), (f), and (g) of this section for purposes of determining who is considered an employee of an employer and what plans are considered maintained by an employer.

(2) *Five-percent owner.* For purposes of this paragraph (h), the term "five-percent owner" has the same meaning as the term "5-percent owner" provided in section 416(i).

(3) *Determination of plan to be disqualified.* If pursuant to this paragraph (h), more than one plan is subject to disqualification, and at least one of the plans would not be disqualified if another plan or plans were disqualified first, all affected plan sponsors may, by agreement, elect the plan or plans subject to disqualification, provided that such election is not inconsistent with the purposes of this paragraph (h), such as where the plan or plans elected were terminated or substantial assets were removed therefrom in a year for which the statute of limitations has run with respect to the employer, employee, or trust. In the absence of such an election, the Commissioner, taking into account all the facts and circumstances, shall have the discretion to determine which plan or plans shall be disqualified.

(i) *Application of the section 416 top-heavy rules under section 414(o).* For purposes of paragraphs (b), (c), and (g) of this section (relating to leased owners, leased managers, and inside directors, respectively), the section 416 top-heavy rules relating to the definition of a key employee shall be applied as if—

(1) Leased owners and leased managers are employees for purposes of section 416(i), and

(2) Section 416(i)(1)(A) contains a section 416(i)(1)(A)(v) which provides "a director of any person included in the employer".

(j) *Highly compensated employees, etc.* If an individual treated as an employee of a recipient under either this section or section 414(n) and the regulations thereunder would be considered a highly compensated employee, officer, or shareholder, with respect to such recipient under Subchapter D if such individual were an employee of such recipient, such individual shall, for purposes of the nondiscrimination rules of Subchapter D, be considered an employee of the recipient who is highly compensated, an officer, or a shareholder. See section 414(q) for the definition of "highly compensated employee" for years beginning after December 31, 1986 or later, depending on the applicable effective date of the particular employee benefit requirement.

(k) *Effective dates.* (1) The provisions of paragraphs (f), (g) and (h) of this section are effective for plan years beginning after [Insert date sixty days after this document is published in the **Federal Register** as a Treasury Decision]. For purposes of applying paragraph (g) to plan years beginning after the effective date of such paragraph, contributions, forfeitures and benefits provided during the current plan year (i.e., the first plan year ending on or after [Insert date this document is published in the **Federal Register**]) and all subsequent plan years ending before the first plan year beginning after the effective date of paragraph (g), shall be taken into account if they would have been taken into account had paragraph (g) of this section been effective for such plan years.

(2) The provisions of paragraph (b) of this section are effective for tax years of recipients beginning after December 31, 1983. Therefore, the provisions of paragraph (b) apply to plan years beginning during and after the first tax year of a recipient beginning after December 31, 1983. For purposes of applying paragraph (b) of this section to plan years beginning during and after the first tax year of a recipient beginning after December 31, 1983, contributions, forfeitures and benefits provided during any plan year beginning prior to the first tax year of a recipient beginning after December 31, 1983, shall be taken into account if they would have been taken into account had paragraph (b) been effective for such prior plan year.

(3) The provisions of paragraphs (c) and (e) of this section are effective for plan years beginning after [Insert date six months after this document is published in the **Federal Register**]. For purposes of applying paragraph (c) to plan years beginning after the effective date of such paragraph, contributions, forfeitures and benefits provided during the current plan year (i.e., the first plan year ending on or after [Insert date this document is published in the **Federal Register**] and, if applicable the subsequent plan years ending before the first plan year beginning after the effective date of paragraph (c), shall be taken into account if they would have been taken into account had paragraph (c) been effective for such plan year(s).

(4) For purposes of applying the effective dates contained in this paragraph (k), rules similar to those provided in the second and fourth sentences of § 1.414(n)–3(c)(1) shall apply.

James I. Owens,

Acting Commissioner.

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