

**§ 1.414(r)-2 Line of business.**

(a) *General rule.* A line of business is a portion of an employer that is identified by the property or services it provides to customers of the employer. For this purpose, an employer is permitted to determine its lines of business by designating the property or services that each of its lines of business provides to customers of the employer. Paragraph (b) of this section explains how an employer determines its lines of business for a testing year. Paragraph (c) of this section provides examples illustrating the application of this section.

(b) *Employer determination of its lines of business—(1) In general.* An employer determines its lines of business for a testing year first by identifying all the property and services it provides to its customers during the testing year, and then by designating which portion of the property and services is provided by each of its lines of business.

(2) *Property and services provided to customers—(i) In general.* Property, whether real or personal, tangible or intangible, is provided by an employer to a customer if the employer provides the property to or on behalf of the customer for consideration. Similarly, services are provided by an employer to a customer if the employer renders the services to or on behalf of the customer for consideration. An individual item of property or service is taken into account under this paragraph (b)(2) only if the employer provides the item to a person other than the employer in the ordinary course of a trade or business conducted by the employer and the person to whom the employer provides the item is acting in the capacity of a customer of the employer. A type of tangible property is deemed to be provided to customers of the employer for purposes of this section if, with respect to a business that produces or manufactures that type of tangible property, the employer satisfies the special rule in § 1.414(r)-3(d)(2)(iii)(B) for vertically integrated businesses.

(ii) *Timing of provision of property or services.* Generally an employer determines its lines of business on the basis of the property and services it provides to its customers for consideration during the testing year. However, it is not

necessary both that property or services actually be provided, and that consideration for the property or services actually be paid, during the current testing year. For an employer to be considered to provide property or services to customers for consideration during a testing year under this paragraph (b)(2), it is sufficient that the property or services actually be provided to customers during the testing year, the consideration actually be paid during the testing year, or the employer actually incur significant costs during the testing year associated with the provision of the property or services to a specified customer or specified customers.

(3) *Employer designation—(i) In general.* Once the employer has identified all the property and services it provides to its customers during the testing year under paragraph (b)(2) of this section, the employer determines its lines of business for the testing year by designating which portion of those property and services is provided by each of its lines of business. For this purpose, the employer must apportion all the property and services identified under paragraph (b)(2) of this section among its lines of business. An employer generally is not required to designate its lines of business for the testing year in the same manner as it designates its lines of business for any other testing year.

(ii) *Ability to combine unrelated types of property or services in a single line of business.* For purposes of this paragraph (b)(3), there is no requirement that a line of business provide only one type of property or service, or only related types of property or services. Nor is there any requirement that a line of business provide solely property or solely services. Thus, the employer is permitted to combine in a single line of business dissimilar types of property or services that are otherwise unrelated to one another.

(iii) *Ability to separate related types of property or services into two or more lines of business.* For purposes of this paragraph (b)(3), there is no requirement that all property or services of related types or the same type be provided by a single line of business. Thus, the employer is permitted to designate two or

more lines of business that provide related types of property or services, or the same type of property or service. An employer might designate two or more lines of business that provide property or services of related types or the same type, for example, where the lines of business manufacture, prepare, or provide the property or services in different geographic areas (e.g., in different regions of the country or the world), or at different levels in the chain of commercial distribution (e.g., wholesale versus retail), or in different types of transactions (e.g., sale versus lease), or for different types of customers (e.g., governmental versus private), or subject to different legal constraints (e.g., regulated versus unregulated), or if the lines of business have developed differently (e.g., one line of business was acquired while another line of business developed internally). Notwithstanding the foregoing, an employer is not permitted to designate two or more lines of business that provide property or services of related types or the same type, if the employer's designation is unreasonable. An employer's designation would be unreasonable, for example, if the designation separated two types of property or services in different lines of business, but the employer did not provide those types of property or services separately from one another to its customers. Similarly, an employer's designation would be unreasonable if it separated two types of property or services in different lines of business, but the provision of one type of property or service was merely ancillary or incidental to, or regularly associated with, the provision of the other type of property or service. See generally § 1.414(r)-1(d)(2) (requiring an employer's operation of qualified separate lines of business to be for bona fide business reasons).

(iv) *Affiliated service groups.* An employer is not permitted to designate its lines of business in a manner that results in separating employees of an affiliated service group (within the meaning of section 414(m)) from other employees of the employer. See section 414(r)(8).

(c) *Examples*—(1) *In general.* Paragraphs (c)(2) and (c)(3) of this section

provide examples that illustrate the application of this section.

(2) *Examples illustrating employer designation.* The following examples illustrate the application of paragraph (b)(3) of this section relating to an employer's designation of the property or services provided to customers by each of its lines of business.

*Example 1.* Employer A is a domestic conglomerate engaged in the manufacture and sale of consumer food and beverage products and the provision of data processing services to private industry. Employer A provides no other property or services to its customers. Pursuant to paragraph (b)(3) of this section, Employer A apportions all the property and services it provides to its customers among three lines of business, one providing all its consumer food products, a second providing all its consumer beverage products, and a third providing all its data processing services. Employer A has three lines of business for purposes of this section.

*Example 2.* The facts are the same as in *Example 1*, except that Employer A determines that neither the consumer food products line of business nor the consumer beverage products line of business would satisfy the separateness criteria of § 1.414(r)-3 for recognition as a separate line of business. Accordingly, pursuant to paragraph (b)(3) of this section, Employer A apportions all the property and services it provides to its customers between only two lines of business, one providing all its consumer food and beverage products, and a second providing all its data processing services. Employer A has two lines of business for purposes of this section.

*Example 3.* The facts are the same as in *Example 2*, except that Employer A also owns and operates a regional commuter airline, a professional basketball team, a pharmaceutical manufacturer, and a leather tanning company. Pursuant to paragraph (b)(3) of this section, Employer A apportions all the property and services it provides to its customers among three lines of business, one providing all its consumer food and beverage products, a second providing all its data processing services, and a third providing all the other property and services provided to customers through Employer A's regional commuter airline, professional basketball team, pharmaceutical manufacturer, and leather tanning company. Even though the third line of business includes dissimilar types of property and services that are otherwise unrelated to one another, paragraph (b)(3)(ii) of this section permits Employer A to combine these property and services in a single line of business. Employer A has three lines of business for purposes of this section.

*Example 4.* The facts are the same as in *Example 2*, except that Employer A has recently

acquired Corporation L, whose only product is a well-known brand of gourmet ice cream. Although Employer A manufactures and sells other ice cream products, it does not manufacture or market the newly acquired brand of gourmet ice cream except through Corporation L. Pursuant to paragraph (b)(3) of this section, Employer A apportions all the property and services it provides to its customers among three lines of business, one providing only the newly acquired brand of gourmet ice cream, a second providing all its other consumer food and beverage products (including the other ice cream products manufactured and sold by Employer A) and a third providing all its data processing services. Even though the gourmet ice cream line of business provides the same type of property as the consumer food and beverage line of business (i.e., ice cream), paragraph (b)(3)(iii) of this section permits Employer A to separate its ice cream products between two different lines of business. Employer A has three lines of business for purposes of this section.

*Example 5.* The facts are the same as in *Example 2*, except that Employer A operates the data processing services portion of its business in two separate subsidiaries, one serving customers in the eastern half of the United States and the other serving customers in the western half of the United States. Pursuant to paragraph (b)(3) of this section, Employer A apportions all the property and services it provides to its customers among three lines of business, one providing all its consumer food and beverage products, a second providing data processing services to customers in the eastern half of the United States, and a third providing data processing services to customers in the western half of the United States. Even though the second and third lines of business provide the same type of service (i.e., data processing services), paragraph (b)(3)(iii) of this section permits Employer A to separate its data processing services into two lines of business. Employer A has three lines of business for purposes of this section.

*Example 6.* Employer B is a diversified engineering firm offering civil, chemical, and aeronautical engineering services to government and private industry. Employer B provides no other property or services to its customers. Employer B operates the aeronautical engineering services portion of its business as two separate divisions, one serving federal government customers and the other serving customers in private industry. Pursuant to paragraph (b)(3) of this section, Employer B apportions all the property and services it provides to its customers among four lines of business, one providing all its civil engineering services, a second providing all its chemical engineering services, a third providing aeronautical engineering services to federal government customers, and a

fourth providing aeronautical engineering services to customers in private industry. Even though the third and fourth lines of business include the same type of service (i.e., aeronautical engineering services), paragraph (b)(3)(iii) of this section permits Employer B to separate its aeronautical engineering services into two lines of business. Employer B has four lines of business for purposes of this section.

*Example 7.* Among its other business activities, Employer C manufactures industrial diesel generators. At no additional cost to its buyers, Employer C warrants the proper functioning of its diesel generators for a one-year period following sale. Pursuant to its warranty, Employer C provides labor and parts to repair or replace any components that malfunction within the one-year warranty period. Because Employer C does not provide the industrial diesel generators, on the one hand, and the warranty repair services and replacement parts, on the other hand, separately from one another to its customers, under paragraph (b)(3)(iii) of this section it would be unreasonable for Employer C to separate these property and services in different lines of business.

*Example 8.* Among its other business activities, Employer D leases office photocopying equipment. Employer D also provides photocopying supplies and repair services to its lessees for a separate charge. Employer D generally does not provide such supplies and repair services to persons other than its lessees. Lessees of Employer D's equipment are permitted to use photo-copying supplies and repair services from suppliers other than Employer D. Because the provision of the photo-copying supplies and repair services are merely ancillary or incidental to the provision of the leased photo-copiers, under paragraph (b)(3)(iii) of this section it would be unreasonable for Employer D to separate these property and services in different lines of business.

*Example 9.* Employer E operates a medical clinic. The employees of the clinic include physicians, nurses, and laboratory technicians, all of whom participate in providing medical and related services to patients of the clinic. Under paragraph (b)(3)(iii) of this section, it would be unreasonable for Employer E to separate the services of the physicians, nurses, and laboratory technicians in different lines of business.

*Example 10.* Employer F is a law firm. The employees of the firm include lawyers, paralegals, and secretaries, all of whom participate in rendering legal and related services to clients of the firm. Under paragraph (b)(3)(iii) of this section, it would be unreasonable for Employer F to separate the services of the lawyers, paralegals, and secretaries in different lines of business.

*Example 11.* Employer G is a management consulting firm. The employees of the firm

include management consultants, secretaries, and other support staff personnel, all of whom participate in rendering management consulting and related services to clients of the firm. Under paragraph (b)(3)(iii) of this section, it would be unreasonable for Employer G to separate the services of the management consultants, secretaries, and other support staff personnel in different lines of business.

(3) *Examples illustrating property and services provided to customers.* The following examples illustrate the application of paragraph (b)(2) of this section relating to property and services provided to customers of the employer.

*Example 1.* Employer H operates several dairy farms and dairy product processing plants. The dairy farms provide part of their output of milk and milk by-products to Employer H's dairy product processing plants and also sell part to retail distributors unrelated to Employer H. The dairy farms' provision of milk and milk by-products to Employer H's dairy product processing plants does not constitute the provision of property or services to customers of Employer H because the milk and milk by-products are not provided to a person other than employer H. However, the dairy farms' provision of milk and milk by-products to independent retail distributors does constitute the provision of property or services to customers of Employer H under paragraph (b)(2) of this section.

*Example 2.* The facts are the same as in *Example 1*, except that the dairy farms provide their entire output of milk and milk by-products to Employer H's dairy product processing plants. The dairy farms' provision of milk and milk by-products to the dairy product processing plants generally does not constitute the provision of property or services to customers of Employer H because the milk and milk by-products are not provided to a person other than Employer H. However, paragraph (b)(2)(i) of this section provides a special rule for vertically integrated businesses that satisfy § 1.414(r)-3(d)(2)(iii)(B). If § 1.414(r)-3(d)(2)(iii)(B) is satisfied, then, under the special rule of paragraph (b)(2)(i) of this section, the milk and milk by-products are deemed to be provided to customers of Employer H.

*Example 3.* Among its other business activities, Employer J manufactures automobiles. Employer J operates a cafeteria at one of its automobile manufacturing facilities. The cafeteria is intended primarily for use by employees of Employer J, but nonemployees are not prohibited from using the cafeteria. The cafeteria charges the same prices to employees and non-employees. Under paragraph (b)(2) of this section, the provision of cafeteria services to employees of Employer J

does not constitute the provision of property or services to customers of Employer J, because the cafeteria services are provided to the employees in their capacity as employees of Employer J and not as customers of Employer J.

*Example 4.* Employer K sells books and periodicals to members of the public and provides telecommunications services to private industry. Employer K periodically acquires and disposes of businesses in both asset and stock transactions. In addition, for its own investment purposes, Employer K acquires and disposes of corporate and other securities. Under paragraph (b)(2) of this section, the sale by Employer K of businesses and investment securities does not constitute the provision of property or services to customers of Employer K, because the sales are not made in the ordinary course of a trade or business conducted by Employer K. However, the sale of published materials and the provision of telecommunications services to persons unrelated to Employer K does constitute the provision of property or services to customers of Employer K.

*Example 5.* Employer L is active in the financial services industry. Subsidiary 1 of Employer L is a brokerage firm that is regulated as a broker-dealer under applicable federal and state law. In its capacity as a dealer, Subsidiary 1 holds in its own inventory securities of unrelated corporations and regularly sells these securities to unrelated persons. Under paragraph (b)(2) of this section, the sale by Subsidiary 1 of the securities to unrelated persons constitutes the provision of property or services to customers of Employer L, because the sales are made in the ordinary course of Subsidiary 1's trade or business as a broker-dealer.

*Example 6.* The facts are the same as in *Example 5*. Subsidiary 2 of Employer L is an insurance company that is regulated under applicable state insurance laws. In managing its investments, Subsidiary 2 regularly makes use of the brokerage services of Subsidiary 1 (which Subsidiary 1 regularly provides to unrelated persons as well). Under paragraph (b)(2) of this section, Subsidiary 1's provision of brokerage services to Subsidiary 2 does not constitute the provision of property or services to customers of Employer L, because the brokerage services are not provided to a person other than Employer L. However, Subsidiary 1's provision of brokerage services to unrelated persons does constitute the provision of property or services to customers of Employer L.

*Example 7.* Employer M is a shipbuilder. In a testing year, Employer M enters into a contract with a customer to construct a new cargo ship for delivery two years later. Employer M incurs significant costs designing and planning for the production of the new ship during the testing year, but receives no payments from the customer during that

year. Under paragraph (b)(2) of this section, Employer M is treated as providing the cargo ship to the customer during the testing year.

*Example 8.* The facts are the same as in *Example 7*, except that, pursuant to a request from the customer, Employer M also incurred significant costs developing a prototype and submitting a bid on the new cargo ship in the prior testing year, and that these costs were not reimbursed by the customer. Under paragraph (b)(2) of this section, Employer M is also treated as providing the cargo ship to the customer in the prior testing year.

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**§ 1.414(r)-3 Separate line of business.**

(a) *General rule.* A separate line of business is a line of business (as determined under § 1.414(r)-2) that is organized and operated separately from the remainder of the employer. Paragraph (b) of this section sets forth the rules for determining whether a line of business is organized and operated separately from the remainder of the employer. Paragraph (c) of this section provides certain supplementary rules necessary to apply the requirements of paragraph (b) of this section, as well as examples illustrating the application of those requirements. Paragraph (d) of this section provides an optional rule for lines of business that are vertically integrated.

(b) *Separate organization and operation—(1) In general.* A line of business is organized and operated separately from the remainder of the employer for a testing year only if it satisfies all the requirements of paragraphs (b)(2) through (b)(5) of this section for the testing year.

(2) *Separate organizational unit.* The line of business must be formally organized as a separate organizational unit or group of separate organizational units within the employer. For this purpose, an organizational unit is a corporation, partnership, division, or other unit having a similar degree of organizational formality. This requirement must be satisfied on every day of the testing year.

(3) *Separate financial accountability.* The line of business must be a separate profit center or group of separate profit centers within the employer. This requirement must be satisfied on every

day of the testing year. In addition, the employer must maintain books and records that provide separate revenue and expense information that is used for internal planning and control with respect to each profit center comprising the line of business.

(4) *Separate employee workforce.* The line of business must have its own separate employee workforce. A line of business has its own separate workforce only if at least 90 percent of the employees who provide services to the line of business, and who are not substantial-service employees with respect to any other line of business, are substantial-service employees with respect to the line of business. See paragraph (c)(2) of this section to determine how the percentage in the preceding sentence is calculated for the testing year.

(5) *Separate management.* The line of business must have its own separate management. A line of business has its own separate management only if at least 80 percent of the employees who are top-paid employees with respect to the line of business are substantial-service employees with respect to the line of business. See paragraph (c)(3) of this section to determine how the percentage in the preceding sentence is calculated for the testing year.

(c) *Supplementary rules—(1) In general.* This paragraph (c) provides certain supplementary rules necessary to apply the requirements of paragraph (b) of this section, as well as examples illustrating the application of those requirements.

(2) *Determination of separate employee workforce.* The percentage in paragraph (b)(4) of this section is the fraction (expressed as a percentage)—

(i) The numerator of which is the number of substantial-service employees with respect to the line of business within the meaning of § 1.414(r)-11(b)(2); and

(ii) The denominator of which is the total number of employees who provide services to the line of business within the meaning of paragraph (c)(5) of this section and who are not substantial-service employees with respect to any other line of business.

(3) *Determination of separate management.* The percentage in paragraph