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T.D. 7714

Background

On February 21, 1975, the Federal Register published proposed amendments to the Income Tax Regulations (26 CFR Part 1) under sections 219, 402, 403 and 408 of the Internal Revenue Code of 1954 (40 FR 7661). A new part, containing regulations under Code sections 4973 and 4974 (26 CFR Part 54), was also proposed. A correction notice was published in the Federal Register on March 5, 1975 (40 FR 10187). A supplemental notice was published on November 19, 1975 (40 FR 53593). A notice which withdrew and repropounded part of the notice of February 21, 1975 was published in the Federal Register on March 23, 1979 (44 FR 17754). The amendments were proposed to conform the regulations to section 2002 of the Employee Retirement Income Security Act of 1974 (88 Stat. 958). These final regulations, in general, do not reflect changes and additions made to the tax law by the Tax Reform Act of 1976 (90 Stat. 1520), the Revenue Act of 1978 (92 Stat. 2763), and the Act of October 14, 1978 (P.L. 95-458, 92 Stat. 1255). Thus, these final regulations do not deal with the extension of the period for making individual retirement plan contributions under sections 219(c)(3) and 220(c)(4), the deduction of excess contributions in a subsequent year for which there is an unused limitation under sections 219(c)(5) and 220(c)(6), the additional period to rectify certain excess contributions under section 408(d)(5), and the allowance of rollovers on a more frequent basis under section 408(d)(3)(B).

Due to numerous statutory changes made to sections 402 and 4973 since the publication of the first notice, proposed regulations under those sections have been withdrawn and will be repropounded at a later date.

Special Effective Date for Rollovers

If an individual engages in a transaction described in section 408(d)(3)(A)(i) (relating to rollover contributions) on or before April 15, 1976, the first such transaction by the individual on or before April 15, 1976, will not be taken into account for purposes of applying the three year limitation rule of section 408(d)(3)(B) in effect for taxable years beginning before January 1, 1978.

Temporary Regulations Superseded

Section 11.408(a)(2)-1 of the Temporary Income Tax Regulations under the Employee Retirement Income Security Act of 1974 is superseded by § 1.408-2(b)(2).

Drafting Information

The principal author of this regulation was William D. Gibbs 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 Department participated in developing *52783 the regulation, both on matters of substance and style.

Adoption of Amendments to the Regulations

Accordingly-1. The following sections of the proposed regulations are withdrawn: (a) Section 1.219 as set forth in paragraph 3 of the February 21, 1975, notice of proposed rulemaking.

(b) Section 1.402(a)(5) as set forth in paragraph 4 of the February 21, 1975, notice of proposed rulemaking.

(c) Section 1.402(a)-3 as set forth in paragraph 5 of the February 21, 1975, notice of proposed rulemaking.

(d) Section 1.403(a)(4) as set forth in paragraph 6 of the February 21, 1975, notice of proposed rulemaking.

(e) Section 1.403(a)-3 as set forth in paragraph 7 of the February 21, 1975, notice of proposed rulemaking.

(f) Section 1.408 as set forth in paragraph 8 of the February 21, 1975, notice of proposed rulemaking.

(g) Section 1.409 as set forth in paragraph 8 of the February 21, 1975, notice of proposed rulemaking.

(h) Sections 54.4973, 54.4973-1 and

54.4974 as set forth in paragraph 9 of the February 21, 1975, notice of proposed rulemaking.

2. The amendments to 26 CFR, Parts 1 and 54, are hereby adopted, subject to the changes indicated below.

Income Tax Regulations (26 CFR Part 1)

Paragraph 1. Paragraphs (a) and (b) of § 1.219-1, as set forth in paragraph 3 of the appendix to the February 21, 1975, notice of proposed rulemaking, are revised to read as follows:

§ 1.219-1 Deduction for retirement savings.

(a) In general. Subject to the limitations and restrictions of paragraph (b) and the special rules of paragraph (c)(3) of this section, there shall be allowed a deduction under section 62 from gross income of amounts paid for the taxable year of an individual on behalf of such individual to an individual retirement account described in section 408(a), for an individual retirement annuity described in section 408(b), or for a retirement bond described in section 409. The deduction described in the preceding sentence shall be allowed only to the individual on whose behalf such

individual retirement account, individual retirement annuity, or retirement bond is maintained. The first sentence of this paragraph shall apply only in the case of a contribution of cash. A contribution of property other than cash is not allowable as a deduction under this section. In the case of a retirement bond, a deduction will not be allowed if the bond is redeemed within 12 months of its issue date.

(b) Limitations and restrictions-(1) Maximum deduction. The amount allowable as a deduction under section 219(a) to an individual for any taxable year cannot exceed an amount equal to 15 percent of the compensation includible in the gross income of the individual for such taxable year, or \$1,500, whichever is less.

(2) Restrictions-(1) Individuals covered by certain other plans. No deduction is allowable under section 219(a) to an individual for the taxable year if for any part of such year-

(A) He was an active participant in-

(1) A plan described in section 401 (a) which includes a trust exempt from tax under section 501 (a),

(2) An annuity plan described in section 403 (a),

(3) A qualified bond purchase plan described in section 405 (a), or

(4) A retirement plan established for its employees by the United States, by a State or political subdivision thereof, or by an agency or instrumentality of any of the foregoing, or

(B) Amounts were contributed by his employer for an annuity contract described in section 403 (b) (whether or not the individual's rights in such contract are nonforfeitable).

(ii) Contributions after age 70 1/2 . No deduction is allowable under section 219 (a) to an individual for the taxable year of the individual, if he has attained the age of 70 1/2 before the close of such taxable year.

(iii) Rollover contributions. No deduction is allowable under section 219 for any taxable year of an individual with respect to a rollover contribution described in section 402 (a) (5), 402 (a) (7), 403 (a) (4), 403 (b) (8), 408 (d) (3), or 409 (b) (3) (C).

(3) Amounts contributed under endowment contracts. (i) For any taxable year, no deduction is allowable under section 219 (a) for amounts paid under an endowment contract described in § 1.408-3 (e) which is allocable under subdivision (ii) of this subparagraph to the cost of life insurance.

(ii) For any taxable year, the cost of current life insurance protection under an endowment contract described in paragraph (b) (3) (i) of this section is the product of the net premium cost, as determined by the Commissioner, and the excess, if any, of the death benefit payable under the contract during the policy year beginning in the taxable year over the cash value of the contract at the end of such policy year.

(iii) The provisions of this subparagraph may be illustrated by the following examples:

Example (1). A, an individual who is otherwise entitled to the maximum deduction allowed under section 219, purchases, at age 20, an endowment contract described in § 1.408-3 (e) which provides for the payment of an annuity of \$100 per month, at age 65, with a minimum death benefit of \$10,000, and an annual premium of \$220. The cash value at the end of the first policy year is 0. The net premium cost, as determined by the Commissioner, for A's age is \$1.61 per thousand dollars of life insurance protection. The cost of current life insurance protection is \$16.10 ($\1.61×10). A's maximum deduction under section 219 with respect to amounts paid under the endowment contract for the taxable year in which the first policy year begins is \$203.90 ($\$220 - \16.10).

Example (2). Assume the same facts as in example (1), except that the cash value at the end of the second policy year is \$200 and the net premium cost is \$1.67 per thousand for A's age. The cost of current life insurance protection is \$16.37 ($\1.67×9.8). A's maximum deduction under section 219 with respect to amounts paid under the endowment contract for the taxable year in which the second policy year begins is \$203.63 ($\$220 - \16.37).

Par. 2. Paragraph (c) (1) of § 1.219-1, as set forth in paragraph 1 of the March 23, 1979, notice of proposed rulemaking is revised to read as follows:

§ 1.219-1 Deduction for Retirement Savings

(c) Definitions and special rules-(1) Compensation. For purposes of this section, the term "compensation" means wages, salaries, professional fees, or other amounts derived from or received for personal service actually rendered (including, but not limited to, commissions paid salesmen, compensation for services on the basis of a percentage of profits, commissions on insurance premiums, tips and bonuses) and includes earned income, as defined in section 401 (c) (2), but does not include amounts derived from or received as earnings or profits from property (including, but not limited to, interest and dividends) or amounts not includible in gross income.

Par. 3. Paragraphs (c) and (f) of § 1.219-2, as set forth in paragraph 2 of the March 23, 1979, notice of proposed rulemaking, are revised to read as follows:

§ 1.219-2 Definition of Active Participant

(c) Money purchase plan. An individual is an active participant in a money purchase plan if under the terms of the plan employer contributions must be allocated to the individual's account with respect to the plan year ending with or within the individual's taxable year. This rule applies even if an individual is not employed at any time during the individual's taxable year.

(f) Certain individuals not active participants. For purposes of this section, an individual is not an active participant under a plan for any taxable year of such individual for which such individual elects, pursuant to the plan, not to participate in such plan.

Par. 4. Paragraph (d)(4) of § 1.408-1 is redesignated as paragraph (d)(4) of § 1.408-6, which appears below. The remainder of § 1.408-1, as set forth in paragraph 8 in the appendix to the February 21, 1975, notice of proposed rulemaking, is revised to read as follows:

§ 1.408-1 General Rules

(a) In general. Section 408 prescribes rules relating to individual retirement accounts and individual retirement annuities. In addition to the rules set forth in §§ 1.408-2 and 1.408-3, relating respectively to individual retirement accounts and individual retirement annuities, the rules set forth in this section shall also apply.

*52784 (b) Exemption from tax. The individual retirement account or individual retirement annuity is exempt from all taxes under subtitle A of the Code other than the taxes imposed under section 511, relating to tax on unrelated business income of charitable, etc., organizations.

(c) Sanctions-(1) Excess contributions. If an individual retirement account or individual retirement annuity accepts and retains excess contributions, the individual on whose behalf the account is established or who is the owner of the annuity will be subject to the excise tax imposed by section 4973.

(2) Prohibited transactions by owner or beneficiary of individual retirement account-(i) Under section 408(e)(2), if, during any taxable year of the individual for whose benefit any individual retirement account is established, that individual or the individual's beneficiary engages in any transaction prohibited by section 4975 with respect to such account, such account ceases to be an individual retirement account as of the first day of such taxable year. In any case in which any individual retirement account ceases to be an individual retirement account by reason of the preceding sentence as of the first day of any taxable year, section 408(d)(1) applies as if there were a distribution on such first day in an amount equal to the fair market value (on such first day) of all assets in the account (on such first day). The preceding sentence applies even though part of the fair market value of the individual retirement account as of the first day of the taxable year is attributable to excess contributions which may be returned tax-free under section 408(d)(4) or 408(d)(5).

(ii) If the trust with which the individual engages in any transaction described in subdivision (i) of this subparagraph is established by an employer or employee association under section 408(c), only the employee who engages in the prohibited transaction is subject to disqualification of his separate account.

(3) Prohibited transaction by person other than owner or beneficiary of account. If any person other than the individual on whose behalf an individual retirement account is established or the individual's beneficiary engages in any transaction prohibited by section 4975 with respect to such account, such person shall be subject to the taxes imposed by section 4975.

(4) Pledging account as security. Under section 408(e)(4), if, during any taxable year of the individual for whose benefit an individual retirement account is established, that individual uses the account or any portion thereof as security for a loan, the portion so used is treated as distributed to that individual.

(5) Borrowing on annuity contract. Under section 408(e)(3), if during any taxable year the owner of an individual retirement annuity borrows any money under or by use of such contract, the contract ceases to be an individual retirement annuity as of the first day of such taxable year. See § 1.408-3(c).

(6) Premature distributions. If a distribution (whether a deemed distribution or an actual distribution) is made from an individual retirement account, or individual retirement annuity, to the individual for whose benefit the account was established, or who is the owner of the annuity, before the individual attains age 59 1/2 (unless the individual has become disabled within the meaning of section 72(m)(7)), the tax under Chapter 1 of the Code for the taxable year in which such distribution is received is increased under section 408 (f)(1) or (f)(2). The increase equals 10 percent of the amount of the distribution which is includible in gross income for the taxable year. Except in the case of the credits allowable under section 31, 39, or 42, no credit can be used to offset the increased tax described in this subparagraph. See, however, § 1.408-4(c)(3).

(d) Limitation on contributions and benefits. An individual retirement account or individual retirement annuity is subject to the limitation on contributions and benefits imposed by section 415 for years beginning after December 31, 1975.

(e) Community property laws. Section 408 shall be applied without regard to any community property laws.

Par. 5. Section 1.408-2, as set forth in paragraph 8 of the appendix to the February 21, 1975, notice of proposed rulemaking and the November 19, 1975, supplemental notice is revised to read as follows:

§ 1.408-2 Individual Retirement Accounts

(a) In general. An individual retirement account must be a trust or a custodial account (see paragraph (d) of this section). It must satisfy the requirements of paragraph (b) of this section in order to qualify as an individual retirement account. It may be established and maintained by an individual, by an employer for the benefit of his employees (see paragraph (c) of this section), or by an employee association for the benefit of its members (see paragraph (c) of this section).

(b) Requirements. An individual retirement account must be a trust created or organized in the United States (as defined in section 7701(a)(9)) for the exclusive benefit of an individual or his beneficiaries. Such trust must be maintained at all times as a domestic trust in the United States. The instrument creating the trust must be in writing and the following requirements must be satisfied.

(1) Amount of acceptable contributions. Except in the case of a contribution to a simplified employee pension described in section 408(k) and a rollover contribution described in section 408(d)(3), 402(a)(5), 402(a)(7), 403(a)(4), 403(b)(8) or 409(b)(3)(C), the trust instrument must provide that contributions may not be accepted by the trustee for the taxable year in excess of \$1,500 on behalf of any individual for whom the trust is maintained. An individual retirement account maintained as a simplified employee pension may provide for the receipt of up to \$7,500 for a calendar year.

(2) Trustee. (i) The trustee must be a bank (as defined in section 401(d)(1) and the regulations thereunder) or another person who demonstrates, in the manner described in paragraph (b)(2)(ii) of this section, to the satisfaction of the Commissioner, that the manner in which the trust will be administered will be consistent with the requirements of section 408 and this section.

(ii) A person may demonstrate to the satisfaction of the Commissioner that the manner in which he will administer the trust will be consistent with the requirements of section 408 only upon the filing of a written application to the Commissioner of Internal Revenue, Attention: E:EP, Internal Revenue Service, Washington, D.C. 20224. Such application must meet the applicable requirements of the regulations under section 401(d)(1), relating to nonbank trustees of pension and profit-sharing trusts benefiting owner-employees.

(iii) Section 11.408(a)(2)-1 of the Temporary Income Tax Regulations under the Employee Retirement Income Security Act of 1974 is superseded by this subparagraph (2).

(3) Life insurance contracts. No part of the trust funds may be invested in life insurance contracts. An individual retirement account may invest in annuity contracts which provide, in the case of death prior to the time distributions commence, for a payment equal to the sum of the premiums paid or, if greater, the cash value of the contract.

(4) Nonforfeatability. The interest of any individual on whose behalf the trust is maintained in the balance of his account must be nonforfeitable.

(5) Prohibition against commingling. (i) The assets of the trust must not be commingled with other property except in a common trust fund or common investment fund.

(ii) For purposes of this subparagraph, the term "common investment fund" means a group trust created for the purpose of providing a satisfactory diversification of investments or a reduction of administrative expenses for the individual participating trusts, and which group trust satisfies the requirements of section 408(c) (except that it need not be established by an employer or an association of employees) and the requirements of section 401(a) in the case of a group trust in which one of the individual participating trusts is an employees' trust described in section 401(a) which is exempt from tax under section 501(a).

(iii) For purposes of this subparagraph, the term "individual participating trust" means an employees' trust described in section 401(a) which is exempt from tax under section 501(a) or a trust which satisfies the requirements of section 408(a) provided that in the case of such an employees' trust, such trust would be permitted to participate in such a group trust if all of the other individual participating trusts were employees' trusts described in section 401(a) which are exempt from tax under section 501(a).

(6) Distribution of interest. (i) The trust instrument must provide that the entire interest of the individual for whose benefit the trust is maintained must be distributed to him in accordance with paragraph (b)(6)(ii) or (iii) of this section.

(ii) Unless the provisions of paragraph (b)(6)(iii) of this section apply, the entire interest of the individual must be actually distributed to him not later than the close of his taxable year in which he attains age 70 1/2 .

(iii) In lieu of distributing the individual's entire interest as provided in paragraph (b) (6) (ii) of this section, the interest may be distributed commencing not later than the taxable year described in such paragraph *52785 (b) (6) (ii). In such case, the trust must expressly provide that the entire interest of the individual will be distributed to the individual and the individual's beneficiaries, in a manner which satisfies the requirements of paragraph (b) (6) (v) of this section, over any of the following periods (or any combination thereof)-

(A) The life of the individual,

(B) The lives of the individual and spouse,

(C) A period certain not extending beyond the life expectancy of the individual, or

(D) A period certain not extending beyond the joint life and last survivor expectancy of the individual and spouse.

(iv) The life expectancy of the individual or the joint life and last survivor expectancy of the individual and spouse cannot exceed the period computed by use of the expected return multiples in § 1.72-9, or, in the case of payments under a contract issued by an insurance company, the period computed by use of the mortality tables of such company.

(v) If an individual's entire interest is to be distributed over a period described in paragraph (b) (6) (iii) of this section, beginning in the year the individual attains 70 1/2 the amount to be distributed each year must be not less than the lesser of the balance of the individual's entire interest or an amount equal to the quotient obtained by dividing the entire interest of the individual in the trust at the beginning of such year (including amounts not in the individual retirement account at the beginning of the year because they have been withdrawn for the purpose of making a rollover contribution to another individual retirement plan) by the life expectancy of the individual (or the joint life and last survivor expectancy of the individual and spouse (whichever is applicable)), determined in either case as of the date the individual attains age 70 in accordance with paragraph (b) (6) (iv) of this section, reduced by one for each taxable year commencing after the individual's attainment of age 70 1/2 . An annuity or endowment contract issued by an insurance company which provides for non-increasing payments over one of the periods described in paragraph (b) (6) (iii) of this section beginning not later than the close of the taxable year in which the individual attains age 70 1/2 satisfies this provision. However, no distribution need be made in any year, or a lesser amount may be distributed, if beginning with the year the individual attains age 70 1/2 the aggregate amounts distributed by the end of any year are at least equal to the aggregate of the minimum amounts required by this subdivision to have been distributed by the end of such year.

(vi) If an individual's entire interest is distributed in the form of an annuity contract, then the requirements of section 408 (a) (6) are satisfied if the distribution of such contract takes place before the close of the taxable year described in subdivision (ii) of this subparagraph, and if the individual's interest will be paid over a period described in subdivision (iii) of this subparagraph and at a rate which satisfies the requirements of subdivision (v) of this subparagraph.

(vii) In determining whether paragraph (b) (6) (v) of this section is satisfied, all individual retirement plans maintained for an individual's benefit (except those under which he is a beneficiary described in section 408 (a) (7)) at the close of the taxable year in which he reaches

age 70 1/2 must be aggregated. Thus, the total payments which such individual receives in any taxable year must be at least equal to the amount he would have been required to receive had all the plans been one plan at the close of the taxable year in which he attained age 70 1/2 .

(7) Distribution upon death. (i) The trust instrument must provide that if the individual for whose benefit the trust is maintained dies before the entire interest in the trust has been distributed to him, or if distribution has been commenced as provided in paragraph (b) (6) of this section to the surviving spouse and such spouse dies before the entire interest has been distributed to such spouse, the entire interest (or the remaining part of such interest if distribution thereof has commenced) must, within 5 years after the individual's death (or the death of the surviving spouse) be distributed or applied to the purchase of an immediate annuity for this beneficiary or beneficiaries (or the beneficiary or beneficiaries of the surviving spouse) which will be payable for the life of such beneficiary or beneficiaries (or for a term certain not extending beyond the life expectancy of such beneficiary or beneficiaries) and which annuity contract will be immediately distributed to such beneficiary or beneficiaries. A contract described in the preceding sentence is not includible in gross income upon distribution. Section 1.408-4 (e) provides rules applicable to the taxation of such contracts. The first sentence of this paragraph (b) (7) shall have no application if distributions over a term certain commenced before the death of the individual for whose benefit the trust was maintained and the term certain is for a period permitted under paragraph (b) (6) (iii) (C) or (D) of this section.

(ii) Each such beneficiary (or beneficiary of a surviving spouse) may elect to treat the entire interest in the trust (or the remaining part of such interest if distribution thereof has commenced) as an account subject to the distribution requirements of section 408 (a) (6) and paragraph (b) (6) of this section instead of those of section 408 (a) (7) and paragraph (b) (7) of this section. Such an election will be deemed to have been made if such beneficiary treats the account in accordance with the requirements of section 408 (a) (6) and paragraph (b) (6) of this section. An election will be considered to have been made by such beneficiary if either of the following occurs: (A) any amounts in the account (including any amounts that have been rolled over, in accordance with the requirements of section 408 (d) (3) (A) (i), into an individual retirement account, individual retirement annuity, or retirement bond for the benefit of such individual) have not been distributed within the appropriate time period required by section 408 (a) (7) and paragraph (b) (7) of this section; or (B) any additional amounts are contributed to the account (or to the account, annuity, or bond to which the beneficiary has rolled such amounts over, as described in (1) above) which are subject, or deemed to be subject, to the distribution requirements of section 408 (a) (6) and paragraph (b) (6) of this section.

(8) Definition of beneficiaries. The term "beneficiaries" on whose behalf an individual retirement account is established includes (except where the context indicates otherwise) the estate of the individual, dependents of the individual, and any person designated by the individual to share in the benefits of the account after the death of the individual.

(c) Accounts established by employers and certain association of employees-(1) In general. A trust created or organized in the United States (as defined in section 7701 (a) (9)) by an employer for the exclusive benefit of his employees or their beneficiaries, or by an association of employees for the exclusive benefit of its members or their beneficiaries, is treated as an individual retirement account if the requirements of paragraphs (c) (2) and (c) (3) of this section are satisfied under the written governing instrument creating the trust. A trust described in the preceding sentence is for the exclusive benefit of employees or member even though it may

maintain an account for former employees or members and employees who are temporarily on leave.

(2) General requirements. The trust must satisfy the requirements of paragraphs (b) (1) through (7) of this section.

(3) Special requirement. There must be a separate accounting for the interest of each employee or member.

(4) Definitions-(i) Separate accounting. For purposes of paragraph (c) (3) of this section, the term "separate accounting" means that separate records must be maintained with respect to the interest of each individual for whose benefit the trust is maintained. The assets of the trust may be held in a common trust fund, common investment fund, or common fund for the account of all individuals who have an interest in the trust.

(ii) Employee association. For purposes of this paragraph and section 408 (c), the term "employee association" means any organization composed of two or more employees, including, but not limited to, an employee association described in section 501 (c) (4). Such association may include employees within the meaning of section 401 (c) (1). There must be, however, some nexus between the employees (e.g., employees of same employer, employees in the same industry, etc.) in order to qualify as an employee association described in this subdivision (ii).

(d) Custodial accounts. For purposes of this section and section 408(a), a custodial account is treated as a trust described in section 408(a) if such account satisfies the requirements of section 408(a) except that it is not a trust and if the assets of such account are held by a bank (as defined in section 401(d)(1) and the regulations thereunder) or such other person who satisfies the requirements of paragraph (b)(2)(ii) of this section. For purposes of this chapter, in the case of a custodial account treated as a trust by reason of the preceding sentence, the custodian of such account will be treated as the trustee thereof.

Par. 6. Section 1.408-3, as set forth in paragraph 8 of the appendix to the February 21, 1975, notice of proposed *52786 rulemaking, is revised to read as follows:

§ 1.408-3 Individual retirement annuities.

(a) In general. An individual retirement annuity is an annuity contract or endowment contract (described in paragraph (e)(1) of this section) issued by an insurance company which is qualified to do business under the law of the jurisdiction in which the contract is sold and which satisfies the requirements of paragraph (b) of this section. A participation certificate is a group contract issued by an insurance company described in this paragraph will be treated as an individual retirement annuity if the contract satisfies the requirement of paragraph (b) of this section; the certificate of participation sets forth the requirements of paragraph (1) through (5) of section 408(b); the contract provides for a separate accounting of the benefit allocable to each participant-owner; and the group contract is for the exclusive benefit of the participant owners and their beneficiaries. For purposes of this title, a participant-owner of a group contract described in this paragraph shall be treated as the owner of an individual retirement annuity. A contract will not be treated as other than an individual retirement annuity merely because it provides for waiver of premium on disability. An individual retirement annuity contract which satisfies the requirements of section 408(b) need not be purchased under a trust if the

requirements of paragraph (b) of this section are satisfied. An individual retirement endowment contract may not be held under a trust which satisfies the requirements of section 408(a). Distribution of the contract is not a taxable event. Distributions under the contract are includible in gross income in accordance with the provisions of § 1.408-4 (e).

(b) Requirements-(1) Transferability. The annuity or the endowment contract must not be transferable by the owner. an annuity or endowment contract is transferable if the owner can transfer any portion of his interest in the contract to any person other than the issuer thereof. Accordingly, such a contract is transferable if the owner can sell, assign discount, or pledge as collateral for a loan or as security for the performance of an obligation or for any other purpose his interest in the contract to any person other than the issuer thereof. On the other hand, a contract is not to be considered transferable merely because the contract contains: a provision permitting the individual to designate a beneficiary to receive the proceeds in the event of his death, a provision permitting the individual to elect a joint and survivor annuity, or other similar provisions.

(2) Annual premium. Except in the case of a contribution to a simplified employee pension described in section 408(k), the annual premium on behalf of any individual for the annuity or the endowment contract cannot exceed \$1,500. Any refund of premiums must be applied before the close of the calendar year following the year of the refund toward the payment of future premiums or the purchase of additional benefits.

(3) Distribution. The entire interest of the owner must be distributed to him in the same manner and over the same period as described in § 1.408-2 (b) (6).

(4) Distribution upon death. If the owner dies before the entire interest has been distributed to him, or if distribution has commenced to the surviving spouse, the remaining interest must be distributed in the same manner, over the same period, and to the same beneficiaries as described in § 1.408-2 (b) (7).

(5) Nonforfeitability. The entire interest of the owner in the annuity or endowment contract must be nonforfeitable.

(6) Flexible premium. (Reserved)

(c) Disqualification. If during any taxable year the owner of an annuity borrows any money under the annuity or endowment contract or by use of such contract (including, but not limited to, pledging the contract as security for any loan), such contract will cease to be an individual retirement annuity as of the first day of such taxable year, and will not be an individual retirement annuity at any time thereafter. If an annuity or endowment contract which constitutes an individual retirement annuity is disqualified as a result of the preceding sentence, an amount equal to the fair market value of the contract as of the first day of the taxable year of the owner in which such contract is disqualified is deemed to be distributed to the owner. Such owner shall include in gross income for such year an amount equal to the fair market value of such contract as of such first day. The preceding sentence applies even though part of the fair market value of the individual retirement annuity as of the first day of the taxable year is attributable to excess contributions which may be returned tax-free under section 408 (d) (4) or 408 (d) (5).

(d) Premature distribution tax on deemed distribution. If the individual has not attained age 59 1/2 before the beginning of the year in which the disqualification described in paragraph (c) of this section occurs, see section 408 (f) (2) for additional tax on premature distributions.

(e) Endowment contracts-(1) Additional requirements for endowment contracts. No contract providing life insurance protection issued by a company described in paragraph (a) of this section shall be treated as an endowment contract for purposes of this section if-

(i) Such contract matures later than the taxable year in which the individual in whose name the contract is purchased attains the age of 70 1/2 ;

(ii) Such contract is not for the exclusive benefit of such individual or his beneficiaries;

(iii) Premiums under the contract may increase over the term of the contract;

(iv) When all premiums are paid when due, the cash value of such contract at maturity is less than the death benefit payable under the contract at any time before maturity;

(v) The death benefit does not, at some time before maturity, exceed the greater of the cash value or the sum of premiums paid under the contract;

(vi) Such contract does not provide for a cash value;

(vii) Such contract provides that the life insurance element of such contract may increase over the term of such contract, unless such increase is merely because such contract provides for the purchase of additional benefits;

(viii) Such contract provides insurance other than life insurance and waiver of premiums upon disability; or

(ix) Such contract is issued after November 6, 1978.

(2) Treatment of proceeds under endowment contract upon death of individual. In the case of the payment of a death benefit under an endowment contract upon the death of the individual in whose name the contract is purchased, the portion of such payment which is equal to the cash value immediately before the death of such individual is not excludable from gross income under section 101(a) and is treated as a distribution from an individual retirement annuity. The remaining portion, if any, of such payment constitutes current life insurance protection and is excludable under section 101(a). If a death benefit is paid under an endowment contract at a date or dates later than the death of the individual, section 101(d) is applicable only to the portion of the benefit which is attributable to the amount excludable under section 101(a).

Par. 7. There are inserted after § 1.408-3 the following new sections.

§ 1.408-4 Treatment of distributions from individual retirement arrangements.

(a) General rule-(1) Inclusion in income. Except as otherwise provided in this section, any amount actually paid or distributed or deemed paid or distributed from an individual retirement

account or individual retirement annuity shall be included in the gross income of the payee or distributee for the taxable year in which the payment or distribution is received.

(2) Zero basis. Notwithstanding section 1015(d) or any other provision of the Code, the basis (or investment in the contract) of any person in such an account or annuity is zero. For purposes of this section, an assignment of an individual's rights under an individual retirement account or an individual retirement annuity shall, except as provided in § 1.408-4(g) (relating to transfer incident to divorce), be deemed a distribution to such individual from such account or annuity of the amount assigned.

(b) Rollover contribution-(1) To individual retirement arrangement. Paragraph (a)(1) of this section shall not apply to any amount paid or distributed from an individual retirement account or individual retirement annuity to the individual for whose benefit the account was established or who is the owner of the annuity if the entire amount received (including the same amount of money and any other property) is paid into an individual retirement account, annuity (other than an endowment contract), or bond created for the benefit of such individual not later than the 60th day after the day on which he receives the payment or distribution.

(2) To qualified plan. Paragraph (a)(1) of this section does not apply to any amount paid or distributed from an individual retirement account or individual retirement annuity to the individual for whose benefit *52787 the account was established or who is the owner of the annuity if-

(i) No amount in the account or no part of the value of the annuity is attributable to any source other than a rollover contribution from an employees' trust described in section 401(a) which is exempt from tax under section 501(a) or a rollover contribution from an annuity plan described in section 403(a) and the earnings on such sums, and

(ii) The entire amount received (including the same amount of money and any other property) represents the entire amount in the account and is paid into another such trust or plan (for the benefit of such individual) not later than the 60th day after the day on which the payment or distribution is received.

This subparagraph does not apply if any portion of the rollover contribution described in paragraph (b)(2)(i) of this section is attributable to an employees' trust forming part of a plan or an annuity under which the individual was an employee within the meaning of section 401(c)(1) at the time contributions were made on his behalf under the plan.

(3) To section 403(b) contract. [Reserved]

(4) Frequency limitation. (i) For taxable years beginning on or before December 31, 1977, paragraph (b)(1) of this section does not apply to any amount received by an individual from an individual retirement account, annuity or bond if at any time during the 3-year period ending on the day of receipt, the individual received any other amount from an individual retirement account, annuity or bond which was not includible in his gross income because of the application of paragraph (b)(1) of this section.

(ii) [Reserved]

(c) Excess contributions returned before due date of return—(1) Excess contribution. For purposes of this paragraph, excess contributions are the excess of the amounts contributed to an individual retirement account or paid for an individual retirement annuity during the taxable year over the amount allowable as a deduction under section 219 or 220 for the taxable year.

(2) General rule. (i) Paragraph (a)(1) of this section does not apply to the distribution of any excess contribution paid during a taxable year to an account or annuity if: the distribution is received on or before the date prescribed by law (including extensions) for filing the individual's return for such taxable year; no deduction is allowed under section 219 or section 220 with respect to the excess contribution; and the distribution is accompanied by the amount of net income attributable to the excess contribution as of the date of the distribution as determined under subdivision (ii).

(ii) The amount of net income attributable to the excess contributions is an amount which bears the same ratio to the net income earned by the account during the computation period as the excess contribution bears to the sum of the balance of the account as of the first day of the taxable year in which the excess contribution is made and the total contribution made for such taxable year. For purposes of this paragraph, the term "computation period" means the period beginning on the first day of the taxable year in which the excess contribution is made and ending on the date of the distribution from the account.

(iii) For purposes of paragraph (c)(2)(ii), the net income earned by the account during the computation period is the fair market value of the balance of the account immediately after the distribution increased by the amount of distributions from the account during the computation period, and reduced (but not below zero) by the sum of: (A) the fair market value of the balance of the account as of the first day of the taxable year in which the excess contribution is made and (B) the contributions to the account made during the computation period.

(3) Time of inclusion. (i) For taxable years beginning before January 1, 1977, the amount of net income determined under subparagraph (2) is includible in the gross income of the individual for the taxable year in which it is received. The amount of net income thus distributed is subject to the tax imposed by section 408(f)(1) for the year includible in gross income.

(ii) [Reserved]

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

Example. On January 1, 1975, A, age 55, who is a calendar-year taxpayer, contributes \$1,500 to an individual retirement account established for his benefit. For 1975, A is entitled to a deduction of \$1,400 under section 219. For 1975, A does not claim as deductions any other items listed in section 662. A's gross income for 1975 is \$9,334. On April 1, 1976, \$107 is distributed to A from his individual retirement account. As of such date, the balance of the account is \$1,498 [\$1,605—\$107]. There were no other distributions from the account as of such date. The net amount of income earned by the account is \$105 [\$1,498+\$107—(0+\$1,500)]. The net income attributable to the excess contribution is \$7. [\$105×(\$100/\$1,500)]. A's adjusted gross income for 1975 is his gross income for 1975 (\$9,334) reduced by the amount allowable to A as a deduction under section 219 (\$1,400), or \$7,934. A will include the \$7 of the \$107 distributed on April 1, 1976, in his gross income for 1976. Further, A will pay an additional income tax of \$.70 for 1976 under section 408 (f)(1).

(d) Deemed distribution-(1) General rule. In any case in which an individual retirement account ceases to be an individual retirement account by reason of the application of section 408(e)(2), paragraph (a)(1) of this section shall apply as if there were a distribution on the first day of the taxable year in which such account ceases to be an individual retirement account of an amount equal to the fair market value on such day of all of the assets in the account on such day. In the case of a deemed distribution from an individual retirement annuity, see § 1.408-3 (d).

(2) Using account as security. In any case in which an individual for whose benefit an individual retirement account is established uses, directly or indirectly, all or any portion of the account as security for a loan, paragraph (a)(1) of this section shall apply as if there were distributed on the first day of the taxable year in which the loan was made an amount equal to that portion of the account used as security for such loan.

(e) Distribution of annuity contracts. Paragraph (a)(1) of this section does not apply to any annuity contract which is distributed from an individual retirement account and which satisfies the requirements of paragraphs (b) (1), (3), (4) and (5) of section 408. Amounts distributed under such contracts will be taxable to the distributee under section 72. For purposes of applying section 72 to a distribution from such a contract, the investment in such contract is zero.

(f) Treatment of assets distributed from an individual retirement account for the purchase of an endowment contract. Under section 408(e)(5), if all, or any portion, of the assets of an individual retirement account are used to purchase an endowment contract described in § 1.408-3(e) for the benefit of the individual for whose benefit the account is established-

(1) The excess, if any, of the total amount of assets used to purchase such contract over the portion of the assets attributable to life insurance protection shall be treated as a rollover contribution described in section 408(d)(3), and

(2) The portion of the assets attributable to life insurance protection shall be treated as a distribution described in paragraph (a)(1) of this section, except that the provisions of section 408(f) shall not apply to such amount.

(g) Transfer incident to divorce-(1) General rule. The transfer of an individual's interest, in whole or in part, in an individual retirement account, individual retirement annuity, or a retirement bond, to his former spouse under a valid divorce decree or a written instrument incident to such divorce shall not be considered to be a distribution from such an account or annuity to such individual or his former spouse; nor shall it be considered a taxable transfer by such individual to his former spouse notwithstanding any other provision of Subtitle A of the Code.

(2) Spousal account. The interest described in this paragraph (g) which is transferred to the former spouse shall be treated as an individual retirement account of such spouse if the interest is an individual retirement account; an individual retirement annuity of such spouse if such interest is an individual retirement annuity; and a retirement bond of such spouse if such interest is a retirement bond.

§ 1.408-5 Annual reports by trustees or issuers.

(a) In general. The trustee of an individual retirement account or the issuer of an individual retirement annuity shall make annual calendar year reports concerning the status of the account

or annuity. The report shall contain the information required in paragraph (b) and be furnished or filed in the manner and time specified in paragraph (c).

(b) Information required to be included in the annual reports. The annual calendar year report shall contain the following information for transactions occurring during the calendar year-

(1) The amount of contributions;

(2) The amount of distributions;

(3) In the case of an endowment contract, the amount of the premium paid allocable to the cost of life insurance;

*52788 (4) The name and address of the trustee or issuer; and

(5) Such other information as the Commissioner may require.

(c) Manner and time for filing. (1) The annual report shall be furnished to the individual on whose behalf the account is established or in whose name the annuity is purchased (or the beneficiary of the individual or owner). The report shall be furnished on or before the 30th day of June following the calendar year for which the report is required.

(2) The Commissioner may require the annual report to be filed with the Service at the time the Commissioner specifies.

(d) Penalties. Section 6693 prescribes penalties for failure to file the annual report.

(e) Effective date. This section shall apply to reports for calendar years after 1978.

(f) Reports for years prior to 1979. For years prior to 1979, a trustee or issuer shall make reports in the time and manner as the Commissioner requires.

Par. 8. There is inserted after § 1.408-5 a new section, and paragraph (d)(4) (x) and (xi) of this new section as redesignated by paragraph 4 of this Treasury decision is revised. The new section reads as follows:

§ 1.408-6 Disclosure statements for individual retirement arrangements.

(a) In general-(1) General rule. Trustees and issuers of individual retirement accounts and annuities are, under the authority of section 408(i), required to provide disclosure statements. This section sets forth these requirements.

(2) [Reserved]

(b) [Reserved]

(c) [Reserved]

(d) Requirements. (1) [Reserved]

(2) [Reserved]

(3) [Reserved]

(4) Disclosure statements.

(x) This section shall be effective for disclosure statements and copies of governing instruments mailed, or delivered without mailing, after February 14, 1977.

(xi) This section does not reflect the amendments made by section 1501 of the Tax Reform Act of 1976 (90 Stat. 1734) relating to retirement savings for certain married individuals.

Par. 9. There is added after § 1.408-6 the following new section:

§ 1.408-7 Reports on distributions from individual retirement plans.

(a) Requirement of report. The trustee of an individual retirement account or the issuer of an individual retirement annuity who makes a distribution during any calendar year to an individual from such account or under such annuity shall make a report on Form W-2P (in the case of distributions that are not total distributions) or Form 1099R (in the case of total distributions), and their related transmittal forms, for such year. The return must show the name and address of the person to whom the distribution was made, the aggregate amount of such distribution, and such other information as is required by the forms.

(b) Amount subject to this section. The amounts subject to reporting under paragraph (a) include all amounts distributed or made available to which section 408(d) applies.

(c) Time and place for filing. The report required under this section for any calendar year shall be filed after the close of that year and on or before February 28 of the following year with the appropriate Internal Revenue Service Center.

(d) Statement to recipients. (1) Each trustee or issuer required to file Form 1099R or Form W-2P under this section shall furnish to the person whose identifying number is (or should be) shown on the forms a copy of the form.

(2) Each statement required by this paragraph to be furnished to recipients shall be furnished to such person after November 30 of the year of the distribution and on or before January 31 of the following year.

(e) Effective date. This section is effective for calendar years beginning after December 31, 1977.

Sec. 7805, Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).

Jerome Kurtz,

Commissioner of Internal Revenue.

Approved: July 18, 1980.

Emil M. Sunley,

Acting Assistant Secretary of the Treasury.

PART 1-INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Paragraph 1. The following new section is added immediately after § 1.218-0:

§ 1.219-1 Deduction for retirement savings.

(a) In general. Subject to the limitations and restrictions of paragraph (b) and the special rules of paragraph (c)(3) of this section, there shall be allowed a deduction under section 62 from gross income of amounts paid for the taxable year of an individual on behalf of such individual to an individual retirement account described in section 408(a), for an individual retirement annuity described in section 408(b), or for a retirement bond described in section 409. The deduction described in the preceding sentence shall be allowed only to the individual on whose behalf such individual retirement account, individual retirement annuity, or retirement bond is maintained. The first sentence of this paragraph shall apply only in the case of a contribution of cash. A contribution of property other than cash is not allowable as a deduction under this section. In the case of a retirement bond, a deduction will not be allowed if the bond is redeemed within 12 months of its issue date.

(b) Limitations and restrictions-(b)(1) Maximum deduction. The amount allowable as a deduction under section 219(a) to an individual for any taxable year cannot exceed an amount equal to 15 percent of the compensation includible in the gross income of the individual for such taxable year, or \$1,500, whichever is less.

(b)(2) Restrictions-(b)(2)(1) Individuals covered by certain other plans. No deduction is allowable under section 219(a) to an individual for the taxable year if for any part of such year-

(b)(2)(1)(A) He was an active participant in-

(1) A plan described in section 401(a) which includes a trust exempt from tax under section 501(a),

(2) An annuity plan described in section 403(a),

(3) A qualified bond purchase plan described in section 405(a), or

(4) A retirement plan established for its employees by the United States, by a State or political subdivision thereof, or by an agency or instrumentality of any of the foregoing, or

(b)(2)(1)(B) Amounts were contributed by his employer for an annuity contract described in section 403(b) (whether or not the individual's rights in such contract are nonforfeitable).

(ii) Contributions after age 70 1/2 . No deduction is allowable under section 219 (a) to an individual for the taxable year of the individual, if he has attained the age of 70 1/2 before the close of such taxable year.

(ii)(iii) Rollover contributions. No deduction is allowable under section 219 for any taxable year of an individual with respect to a rollover contribution described in section 402(a)(5), 402(a)(7), 403(a)(4), 403(b)(8), 408(d)(3), or 409(b)(3)(C).

(ii)(iii)(3) Amounts contributed under endowment contracts. (i) For any taxable year, no deduction is allowable under section 219(a) for amounts paid under an endowment contract described in § 1.408-3(e) which is allocable under subdivision (ii) of this subparagraph to the cost of life insurance.

(ii)(ii) For any taxable year, the cost of current life insurance protection under an endowment contract described in paragraph (b)(3)(i) of this section is the product of the net premium cost, as determined by the Commissioner, and the excess, if any, of the death benefit payable under the contract during the policy year beginning in the taxable year over the cash value of the contract at the end of such policy year.

(ii)(iii) The provisions of this subparagraph may be illustrated by the following examples:

Example (1). A, an individual who is otherwise entitled to the maximum deduction allowed under section 219, purchases, at age 20, an endowment contract described in § 1.408-3(e) which provides for the payment of an annuity of \$100 per month, at age 65, with a minimum death benefit of \$10,000, and \$2789 an annual premium of \$220. The cash value at the end of the first policy year is 0. The net premium cost, as determined by the Commissioner, for A's age is \$1.61 per thousand dollars of life insurance protection. The cost of current life insurance protection is \$16.10 ($\1.61×10). A's maximum deduction under section 219 with respect to amounts paid under the endowment contract for the taxable year in which the first policy year begins is \$203.90 ($\$220 - \16.10).

Example (2). Assume the same facts as in example (1), except that the cash value at the end of the second policy year is \$200 and the net premium cost is \$1.67 per thousand for A's age. The cost of current life insurance protection is \$16.37 ($\1.67×9.8). A's maximum deduction under section 219 with respect to amounts paid under the endowment contract for the taxable year in which the second policy year begins is \$203.63 ($\$220 - \16.37).

(c) Definitions and special rules- (1) Compensation. For purposes of this section, the term "compensation" means wages, salaries, professional fees, or other amounts derived from or received for personal service actually rendered (including, but not limited to, commissions paid salesmen, compensation for services on the basis of a percentage of profits, commissions on insurance premiums, tips, and bonuses) and includes earned income, as defined in section 401 (c) (2), but does not include amounts derived from or received as earnings or profits from

property (including, but not limited to, interest and dividends) or amounts not includible in gross income.

(c)(2) Active participant. For the definition of active participant, see § 1.219-2.

(c)(3) Special rules. (i) The maximum deduction allowable under section 219(b)(1) is computed separately for each individual. Thus, if a husband and wife each has compensation of \$10,000 for the taxable year and they are each otherwise eligible to contribute to an individual retirement account and they file a joint return, then the maximum amount allowable as a deduction under section 219 is \$3,000, the sum of the individual maximums of \$1,500. However, if, for example, the husband has compensation of \$20,000, the wife has no compensation, each is otherwise eligible to contribute to an individual retirement account for the taxable year, and they file a joint return, the maximum amount allowable as a deduction under section 219 is \$1,500.

(ii) Section 219 is to be applied without regard to any community property laws. Thus, if, for example, a husband and wife, who are otherwise eligible to contribute to an individual retirement account, live in a community property jurisdiction and the husband alone has compensation of \$20,000 for the taxable year, then the maximum amount allowable as a deduction under section 219 is \$1,500.

(ii)(4) Employer contributions. For purposes of this chapter, any amount paid by an employer to an individual retirement account or for an individual retirement annuity or retirement bond constitutes the payment of compensation to the employee (other than a self-employed individual who is an employee within the meaning of section 401(c)(1)) includible in his gross income, whether or not a deduction for such payment is allowable under section 219 to such employee after the application of section 219(b). Thus, an employer will be entitled to a deduction for compensation paid to an employee for amounts the employer contributes on the employee's behalf to an individual retirement account, for an individual retirement annuity, or for a retirement bond if such deduction is otherwise allowable under section 162.

§ 1.2192-2 Definition of active participant.

(a) In general. This section defines the term "active participant" for individuals who participate in retirement plans described in section 219(b)(2). Any individual who is an active participant in such a plan is not allowed a deduction under section 219(a) for contributions to an individual retirement account.

(b) Defined benefit plans- (1) In general. Except as provided in subparagraphs (2), (3) and (4) of this paragraph, an individual is an active participant in a defined benefit plan if for any portion of the plan year ending with or within such individual's taxable year he is not excluded under the eligibility provisions of the plan. An individual is not an active participant in a particular taxable year merely because the individual meets the plan's eligibility requirements during a plan year beginning in that particular taxable year but ending in a later taxable year of the individual. However, for purposes of this section, an individual is deemed not to satisfy the eligibility provisions for a particular plan year if his compensation is less than the minimum amount of compensation needed under the plan to accrue a benefit. For example, assume a plan is integrated with Social Security and only those individuals whose compensation exceeds a certain amount accrue benefits under the plan. An individual whose compensation for the plan year

ending with or within his taxable year is less than the amount necessary under the plan to accrue a benefit is not an active participant in such plan.

(b)(2) Rules for plans maintained by more than one employer. In the case of a defined benefit plan described in section 413(a) and funded at least in part by service-related contributions, e.g., so many cents-per-hour, an individual is an active participant if an employer is contributing or is required to contribute to the plan an amount based on that individual's service taken into account for the plan year ending with or within the individual's taxable year. The general rule in paragraph (b)(1) of this section applies in the case of plans described in section 413(a) and funded only on some non-service-related unit, e.g., so many cents-per-ton of coal.

(b)(3) Plans in which accruals for all participants have ceased. In the case of a defined benefit plan in which accruals for all participants have ceased, an individual in such a plan is not an active participant. However, any benefit that may vary with future compensation of an individual provides additional accruals. For example, a plan in which future benefit accruals have ceased, but the actual benefit depends upon final average compensation will not be considered as one in which accruals have ceased.

(b)(4) No accruals after specified age. An individual in a defined benefit plan who accrues no additional benefits in a plan year ending with or within such individual's taxable year by reason of attaining a specified age is not an active participant by reason of his participation in that plan.

(c) Money purchase plan. An individual is an active participant in a money purchase plan if under the terms of the plan employer contributions must be allocated to the individual's account with respect to the plan year ending with or within the individual's taxable year. This rule applies even if an individual is not employed at any time during the individual's taxable year.

(d) Profit-sharing and stock-bonus plans-(d)(1) In general. This paragraph applies to profit-sharing and stock bonus plans. An individual is an active participant in such plans in a taxable year if a forfeiture is allocated to his account as of a date in such taxable year. An individual is also an active participant in a taxable year in such plans if an employer contribution is added to the participant's account in such taxable year. A contribution is added to a participant's account as of the later of the following two dates: the date the contribution is made or the date as of which it is allocated. Thus, if a contribution is made in an individual's taxable year 2 and allocated as of a date in individual's taxable year 1, the later of the relevant dates is the date the contribution is made. Consequently, the individual is an active participant in year 2 but not in year 1 as a result of that contribution.

(d)(2) Special rule. An individual is not an active participant for a particular taxable year by reason of a contribution made in such year allocated to a previous year if such individual was an active participant in such previous year by reason of a prior contribution that was allocated as of a date in such previous year.

(e) Employee contributions. If an employee makes a voluntary or mandatory contribution to a plan described in paragraphs (b), (c), or (d) of this section, such employee is an active participant in the plan for the taxable year in which such contribution is made.

(f) Certain individuals not active participants. For purposes of this section, an individual is not an active participant under a plan for any taxable year of such individual for which such individual elects, pursuant to the plan, not to participate in such plan.

(g) Retirement savings for married individuals. The provisions of this section apply in determining whether an individual or his spouse is an active participant in a plan for purposes of section 220 (relating to retirement savings for certain married individuals).

(h) Examples. The provisions of this section may be illustrated by the following examples:

Example (1). The X Corporation maintains a defined benefit plan which has the following rules on participation and accrual of benefits. Each employee who has attained the age of 25 or has completed one year of service is a participant in the plan. The plan further provides that each participant shall receive upon retirement \$12 per month for each year of service in which the employee completes 1,000 hours of service. The plan year is the calendar year. B, a calendar-year taxpayer, enters the plan on January 2, 1980, when he is 27 years of age. Since B has attained the age of 25, he is a participant in the plan. However, B completes less than 1,000 hours of service in 1980 and 1981. Although B is not accruing any benefits under the plan in 1980 and 1981, he is an active participant under section 219(b)(2) because he is a participant in the plan. Thus, B cannot make deductible contributions to an individual retirement arrangement for his taxable years of 1980 and 1981.

Example (2). The Y Corporation maintains a profit-sharing plan for its employees. The plan year of the plan is the calendar year. C is a calendar-year taxpayer and a participant in the plan. On June 30, 1980, the employer makes a contribution for 1980 which is allocated on July 31, 1980. In 1981 the employer makes a second contribution for 1980, allocated as of December 31, 1980. Under the general rule stated in § 1.219-2(d)(1), C is an active participant in 1980. Under the special rule stated in § 1.219-2(d)(2), however, C is not an active participant in 1981 by reason of that contribution made in 1981.

(i) Effective date. The provisions set forth in this section are effective for taxable years beginning after December 31, 1978.

Par. 2. The following new section is added immediately after § 1.407-1:

§ 1.408-1 General rules.

(a) In general. Section 408 prescribes rules relating to individual retirement accounts and individual retirement annuities. In addition to the rules set forth in §§ 1.408-2 and 1.408-3, relating respectively to individual retirement accounts and individual retirement annuities, the rules set forth in this section shall also apply.

(b) Exemption from tax. The individual retirement account or individual retirement annuity is exempt from all taxes under subtitle A of the Code other than the taxes imposed under section 511, relating to tax on unrelated business income of charitable, etc., organizations.

(c) Sanctions-(c)(1) Excess contributions. If an individual retirement account or individual retirement annuity accepts and retains excess contributions, the individual on whose behalf the

account is established or who is the owner of the annuity will be subject to the excise tax imposed by section 4973.

(c)(2) Prohibited transactions by owner or beneficiary of individual retirement account-(c)(2)(i) Under section 408(e)(2), if, during any taxable year of the individual for whose benefit any individual retirement account is established, that individual or the individual's beneficiary engages in any transaction prohibited by section 4975 with respect to such account, such account ceases to be an individual retirement account as of the first day of such taxable year. In any case in which any individual retirement account ceases to be an individual retirement account by reason of the preceding sentence as of the first day of any taxable year, section 408(d)(1) applies as if there were a distribution on such first day in an amount equal to the fair market value (on such first day) of all assets in the account (on such first day). The preceding sentence applies even though part of the fair market value of the individual retirement account as of the first day of the taxable year is attributable to excess contributions which may be returned tax-free under section 408(d)(4) or 408(d)(5).

(c)(2)(ii) If the trust with which the individual engages in any transaction described in subdivision (i) of this subparagraph is established by an employer or employee association under section 408(c), only the employee who engages in the prohibited transaction is subject to disqualification of his separate account.

(c)(3) Prohibited transaction by person other than owner or beneficiary of account. If any person other than the individual on whose behalf an individual retirement account is established or the individual's beneficiary engages in any transaction prohibited by section 4975 with respect to such account, such person shall be subject to the taxes imposed by section 4975.

(c)(4) Pledging account as security. Under section 408(e)(4), if, during any taxable year of the individual for whose benefit an individual retirement account is established, that individual uses the account or any portion thereof as security for a loan, the portion so used is treated as distributed to that individual.

(c)(5) Borrowing on annuity contract. Under section 408(e)(3), if during any taxable year the owner of an individual retirement annuity borrows any money under or by use of such contract, the contract ceases to be an individual retirement annuity as of the first day of such taxable year. See § 1.408-3(c).

(c)(6) Premature distributions. If a distribution (whether a deemed distribution or an actual distribution) is made from an individual retirement account, or individual retirement annuity, to the individual for whose benefit the account was established, or who is the owner of the annuity, before the individual attains age 59 1/2 (unless the individual has become disabled within the meaning of section 72(m)(7)), the tax under Chapter 1 of the Code for the taxable year in which such distribution is received is increased under section 408(f)(1) or (f)(2). The increase equals 10 percent of the amount of the distribution which is includible in gross income for the taxable year. Except in the case of the credits allowable under section 31, 39, or 42, no credit can be used to offset the increased tax described in this subparagraph. See, however, § 1.408-4(c)(3).

(d) Limitation on contributions and benefits. An individual retirement account or individual retirement annuity is subject to the limitation on contributions and benefits imposed by section 415 for years beginning after December 31, 1975.

(e) Community property laws. Section 408 shall be applied without regard to any community property laws.

*52791 § 1.408-2 Individual retirement accounts.

(a) In general. An individual retirement account must be a trust or a custodial account (see paragraph (d) of this section). It must satisfy the requirements of paragraph (b) of this section in order to qualify as an individual retirement account. It may be established and maintained by an individual, by an employer for the benefit of his employees (see paragraph (c) of this section), or by an employee association for the benefit of its members (see paragraph (c) of this section).

(b) Requirements. An individual retirement account must be a trust created or organized in the United States (as defined in section 7701(a)(9)) for the exclusive benefit of an individual or his beneficiaries. Such trust must be maintained at all times as a domestic trust in the United States. The instrument creating the trust must be in writing and the following requirements must be satisfied.

(b)(1) Amount of acceptable contributions. Except in the case of a contribution to a simplified employee pension described in section 408(k) and a rollover contribution described in section 408(d)(3), 402(a)(5), 402(a)(7), 403(a)(4), 403(b)(8) or 409(b)(3)(C), the trust instrument must provide that contributions may not be accepted by the trustee for the taxable year in excess of \$1,500 on behalf of any individual for whom the trust is maintained. An individual retirement account maintained as a simplified employee pension may provide for the receipt of up to \$7,500 for a calendar year.

(b)(2) Trustee. (i) The trustee must be a bank (as defined in section 401(d)(1) and the regulations thereunder) or another person who demonstrates, in the manner described in paragraph (b)(2)(ii) of this section, to the satisfaction of the Commissioner, that the manner in which the trust will be administered will be consistent with the requirements of section 408 and this section.

(ii) A person may demonstrate to the satisfaction of the Commissioner that the manner in which he will administer the trust will be consistent with the requirements of section 408 only upon the filing of a written application to the Commissioner of Internal Revenue, Attention: E:EP, Internal Revenue Service, Washington, D.C. 20224. Such application must meet the applicable requirements of the regulations under section 401(d)(1), relating to nonbank trustees of pension and profit-sharing trusts benefiting owner-employees.

(ii)(iii) Section 11.408(a)(2)-1 of the Temporary Income Tax Regulations under the Employee Retirement Income Security Act of 1974 is superseded by this subparagraph (2).

(ii)(iii)(3) Life insurance contracts. No part of the trust funds may be invested in life insurance contracts. An individual retirement account may invest in annuity contracts which provide, in the case of death prior to the time distributions commence, for a payment equal to the sum of the premiums paid or, if greater, the cash value of the contract.

(ii)(iii)(4) Nonforfeitability. The interest of any individual on whose behalf the trust is maintained in the balance of his account must be nonforfeitable.

(ii)(iii)(5) Prohibition against commingling. (i) The assets of the trust must not be commingled with other property except in a common trust fund or common investment fund.

(ii)(ii) For purposes of this subparagraph, the term "common investment fund" means a group trust created for the purpose of providing a satisfactory diversification or investments or a reduction of administrative expenses for the individual participating trusts, and which group trust satisfies the requirements of section 408(c) (except that it need not be established by an employer or an association of employees) and the requirements of section 401(a) in the case of a group trust in which one of the individual participating trusts is an employees' trust described in section 401(a) which is exempt from tax under section 501(a).

(ii)(iii) For purposes of this subparagraph, the term "individual participating trust" means an employees' trust described in section 401(a) which is exempt from tax under section 501(a) or a trust which satisfies the requirements of section 408(a) provided that in the case of such an employees' trust, such trust would be permitted to participate in such a group trust if all the other individual participating trusts were employees' trusts described in section 401(a) which are exempt from tax under section 501(a).

(ii)(iii)(6) Distribution of interest. (i) The trust instrument must provide that the entire interest of the individual for whose benefit the trust is maintained must be distributed to him in accordance with paragraph (b)(6)(ii) or (iii) of this section.

(ii)(ii) Unless the provisions of paragraph (b)(6)(iii) of this section apply, the entire interest of the individual must be actually distributed to him not later than the close of his taxable year in which he attains age 70 1/2 .

(ii)(iii) In lieu of distributing the individual's entire interest as provided in paragraph (b)(6)(ii) of this section, the interest may be distributed commencing not later than the taxable year described in such paragraph (b)(6)(ii). In such case, the trust must expressly provide that the entire interest of the individual will be distributed to the individual and the individual's beneficiaries, in a manner which satisfies the requirements of paragraph (b)(6)(v) of this section, over any of the following periods (or any combination thereof)-

(ii)(iii)(A) The life of the individual,

(ii)(iii)(B) The lives of the individual and spouse,

(ii)(iii)(C) A period certain not extending beyond the life expectancy of the individual, or

(ii)(iii)(D) A period certain not extending beyond the joint life and last survivor expectancy of the individual and spouse.

(ii)(iv) The life expectancy of the individual or the joint life and last survivor expectancy of the individual and spouse cannot exceed the period computed by use of the expected return multiples in § 1.72-9, or, in the case of payments under a contract issued by an insurance company, the period computed by use of the mortality tables of such company.

(ii)(v) If an individual's entire interest is to be distributed over a period described in paragraph (b)(6)(iii) of this section, beginning in the year the individual attains 70 1/2 the amount to be

distributed each year must be not less than the lesser of the balance of the individual's entire interest or an amount equal to the quotient obtained by dividing the entire interest of the individual in the trust at the beginning of such year (including amounts not in the individual retirement account at the beginning of the year because they have been withdrawn for the purpose of making a rollover contribution to another individual retirement plan) by the life expectancy of the individual (or the joint life and last survivor expectancy of the individual and spouse (whichever is applicable)), determined in either case as of the date the individual attains age 70 1/2 in accordance with paragraph (b)(6)(iv) of this section, reduced by one for each taxable year commencing after the individual's attainment of age 70 1/2 . An annuity or endowment contract issued by an insurance company which provides for non-increasing payments over one of the periods described in paragraph (b)(6)(iii) of this section beginning not later than the close of the taxable year in which the individual attains age 70 1/2 satisfies this provision. However, no distribution need be made in any year, or a lesser amount may be distributed, if beginning with the year *52792 the individual attains age 70 1/2 the aggregate amounts distributed by the end of any year are at least equal to the aggregate of the minimum amounts required by this subdivision to have been distributed by the end of such year.

(ii)(vi) If an individual's entire interest is distributed in the form of an annuity contract, then the requirements of section 408(a)(6) are satisfied if the distribution of such contract takes place before the close of the taxable year described in subdivision (ii) of this subparagraph, and if the individual's interest will be paid over a period described in subdivision (iii) of this subparagraph and at a rate which satisfies the requirements of subdivision (v) of this subparagraph.

(ii)(vii) In determining whether paragraph (b)(6)(v) of this section is satisfied, all individual retirement plans maintained for an individual's benefit (except those under which he is a beneficiary described in section 408(a)(7)) at the close of the taxable year in which he reaches age 70 1/2 must be aggregated. Thus, the total payments which such individual receives in any taxable year must be at least equal to the amount he would have been required to receive had all the plans been one plan at the close of the taxable year in which he attained age 70 1/2 .

(ii)(vii)(7) Distribution upon death. (i) The trust instrument must provide that if the individual for whose benefit the trust is maintained dies before the entire interest in the trust has been distributed to him, or if distribution has been commenced as provided in paragraph (b)(6) of this section to the surviving spouse and such spouse dies before the entire interest has been distributed to such spouse, the entire interest (or the remaining part of such interest if distribution thereof has commenced) must, within 5 years after the individual's death (or the death of the surviving spouse) be distributed or applied to the purchase of an immediate annuity for this beneficiary or beneficiaries (or the beneficiary or beneficiaries of the surviving spouse) which will be payable for the life of such beneficiary or beneficiaries (or for a term certain not extending beyond the life expectancy of such beneficiary or beneficiaries) and which annuity contract will be immediately distributed to such beneficiary or beneficiaries. A contract described in the preceding sentence is not includible in gross income upon distribution. Section 1.408-4(e) provides rules applicable to the taxation of such contracts. The first sentence of this paragraph (b)(7) shall have no application if distributions over a term certain commenced before the death of the individual for whose benefit the trust was maintained and the term certain is for a period permitted under paragraph (b)(6)(iii) (C) or (D) of this section.

(ii)(ii) Each such beneficiary (or beneficiary of a surviving spouse) may elect to treat the entire interest in the trust (or the remaining part of such interest if distribution thereof has commenced)

as an account subject to the distribution requirements of section 408(a)(6) and paragraph (b)(6) of this section instead of those of section 408(a)(7) and paragraph (b)(7) of this section. Such an election will be deemed to have been made if such beneficiary treats the account in accordance with the requirements of section 408(a)(6) and paragraph (b)(6) of this section. An election will be considered to have been made by such beneficiary if either of the following occurs: (A) any amounts in the account (including any amounts that have been rolled over, in accordance with the requirements of section 408(d)(3)(A)(i), into an individual retirement account, individual retirement annuity, or retirement bond for the benefit of such individual) have not been distributed within the appropriate time period required by section 408(a)(7) and paragraph (b)(7) of this section; or (B) any additional amounts are contributed to the account (or to the account, annuity, or bond to which the beneficiary has rolled such amounts over, as described in (1) above) which are subject, or deemed to be subject, to the distribution requirements of section 408(a)(6) and paragraph (b)(6) of this section.

(ii)(ii)(8) Definition of beneficiaries. The term "beneficiaries" on whose behalf an individual retirement account is established includes (except where the context indicates otherwise) the estate of the individual, dependents of the individual, and any person designated by the individual to share in the benefits of the account after the death of the individual.

(c) Accounts established by employers and certain association of employees. (1) In general. A trust created or organized in the United States (as defined in section 7701(a)(9)) by an employer for the exclusive benefit of his employees or their beneficiaries, or by an association of employees for the exclusive benefit of its members or their beneficiaries, is treated as an individual retirement account if the requirements of paragraphs (c)(2) and (c)(3) of this section are satisfied under the written governing instrument creating the trust. A trust described in the preceding sentence is for the exclusive benefit of employees or members even though it may maintain an account for former employees or members and employees who are temporarily on leave.

(c)(2) General requirements. The trust must satisfy the requirements of paragraphs (b) (1) through (7) of this section.

(c)(3) Special requirement. There must be a separate accounting for the interest of each employee or member.

(c)(4) Definitions. (i) Separate accounting. For purposes of paragraph (c)(3) of this section, the term "separate accounting" means that separate records must be maintained with respect to the interest of each individual for whose benefit the trust is maintained. The assets of the trust may be held in a common trust fund, common investment fund, or common fund for the account of all individuals who have an interest in the trust.

(ii) Employee association. For purposes of this paragraph and section 408(c), the term "employee association" means any organization composed of two or more employees, including but not limited to, an employee association described in section 501(c)(4). Such association may include employees within the meaning of section 401(c)(1). There must be, however, some nexus between the employees (e.g., employees of same employer, employees in the same industry, etc.) in order to qualify as an employee association described in this subdivision (ii).

(d) Custodial accounts. For purposes of this section and section 408(a), a custodial account is treated as a trust described in section 408(a) if such account satisfies the requirements of section 408(a) except that it is not a trust and if the assets of such account are held by a bank (as defined in section 401(d)(1) and the regulations thereunder) or such other person who satisfies the requirements of paragraph (b)(2)(ii) of this section. For purposes of this chapter, in the case of a custodial account treated as a trust by reason of the preceding sentence, the custodian of such account will be treated as the trustee thereof.

§ 1.408-3 Individual retirement annuities.

(a) In general. An individual retirement annuity is an annuity contract or endowment contract (described in paragraph (e) (1) of this section) issued by an insurance company which is qualified to do business under the law of the jurisdiction in which the contract is sold and which satisfies the requirements of paragraph (b) of this section. A *52793 participation certificate in a group contract issued by an insurance company described in this paragraph will be treated as an individual retirement annuity if the contract satisfies the requirements of paragraph (b) of this section; the certificate of participation sets forth the requirements of paragraphs (1) through (5) of section 408 (b); the contract provides for a separate accounting of the benefit allocable to each participant-owner; and the group contract is for the exclusive benefit of the participant owners and their beneficiaries. For purposes of this title, a participant-owner of a group contract described in this paragraph shall be treated as the owner of an individual retirement annuity. A contract will not be treated as other than an individual retirement annuity merely because it provides for waiver of premium on disability. An individual retirement annuity contract which satisfies the requirements of section 408 (b) need not be purchased under a trust if the requirements of paragraph (b) of this section are satisfied. An individual retirement endowment contract may not be held under a trust which satisfies the requirements of section 408 (a). Distribution of the contract is not a taxable event. Distributions under the contract are includible in gross income in accordance with the provisions of § 1.408-4 (e).

(b) Requirements-(b)(1) Transferability. The annuity or the endowment contract must not be transferable by the owner. An annuity or endowment contract is transferable if the owner can transfer any portion of his interest in the contract to any person other than the issuer thereof. Accordingly, such a contract is transferable if the owner can sell, assign, discount, or pledge as collateral for a loan or as security for the performance of an obligation or for any other purpose his interest in the contract to any person other than the issuer thereof. On the other hand, a contract is not to be considered transferable merely because the contract contains: a provision permitting the individual to designate a beneficiary to receive the proceeds in the event of his death, a provision permitting the individual to elect a joint and survivor annuity, or other similar provisions.

(b)(2) Annual premium. Except in the case of a contribution to a simplified employee pension described in section 408 (k), the annual premium on behalf of any individual for the annuity or the endowment contract cannot exceed \$1,500. Any refund of premiums must be applied before the close of the calendar year following the year of the refund toward the payment of future premiums or the purchase of additional benefits.

(b)(3) Distribution. The entire interest of the owner must be distributed to him in the same manner and over the same period as described in § 1.408-2 (b) (6).

(b)(4) Distribution upon death. If the owner dies before the entire interest has been distributed to him, or if distribution has commenced to the surviving spouse, the remaining interest must be distributed in the same manner, over the same period, and to the same beneficiaries as described in § 1.408-2 (b) (7).

(b)(5) Nonforfeitability. The entire interest of the owner in the annuity or endowment contract must be nonforfeitable.

(b)(6) Flexible premium. (Reserved)

(c) Disqualification. If during any taxable year the owner of an annuity borrows any money under the annuity or endowment contract or by use of such contract (including, but not limited to, pledging the contract as security for any loan), such contract will cease to be an individual retirement annuity as of the first day of such taxable year, and will not be an individual retirement annuity at any time thereafter. If an annuity or endowment contract which constitutes an individual retirement annuity is disqualified as a result of the preceding sentence, an amount equal to the fair market value of the contract as of the first day of the taxable year of the owner in which such contract is disqualified is deemed to be distributed to the owner. Such owner shall include in gross income for such year an amount equal to the fair market value of such contract as of such first day. The preceding sentence applies even though part of the fair market value of the individual retirement annuity as of the first day of the taxable year is attributable to excess contributions which may be returned tax-free under section 408(d)(4) or 408(d)(5).

(d) Premature distribution tax on deemed distribution. If the individual has not attained age 59 1/2 before the beginning of the year in which the disqualification described in paragraph (c) of this section occurs, see section 408(f)(2) for additional tax on premature distributions.

(e) Endowment contracts-(e)(1) Additional requirement for endowment contracts. No contract providing life insurance protection issued by a company described in paragraph (a) of this section shall be treated as an endowment contract for purposes of this section if-

(e)(1)(i) Such contract matures later than the taxable year in which the individual in whose name the contract is purchased attains the age of 70 1/2 ;

(e)(1)(ii) Such contract is not for the exclusive benefit of such individual or his beneficiaries;

(e)(1)(iii) Premiums under the contract may increase over the term of the contract;

(e)(1)(iv) When all premiums are paid when due, the case value of such contract at maturity is less than the death benefit payable under the contract at any time before maturity;

(e)(1)(v) The death benefit does not, at some time before maturity, exceed the greater of the cash value or the sum of premiums paid under the contract;

(e)(1)(vi) Such contract does not provide for a cash value;

(e)(1)(vii) Such contract provides that the life insurance element of such contract may increase over the term of such contract, unless such increase is merely because such contract provides for the purchase of additional benefits;

(e)(1)(viii) Such contract provides insurance other than life insurance and waiver of premiums upon disability; or

(e)(1)(ix) Such contract is issued after November 6, 1978.

(e)(2) Treatment of proceeds under endowment contract upon death of individual. In the case of the payment of a death benefit under an endowment contract upon the death of the individual in whose name the contract is purchased, the portion of such payment which is equal to the cash value immediately before the death of such individual is not excludable from gross income under section 101(a) and is treated as a distribution from an individual retirement annuity. The remaining portion, if any, of such payment constitutes current life insurance protection and is excludable under section 101(a). If a death benefit is paid under an endowment contract at a date or dates later than the death of the individual, section 101(d) is applicable only to the portion of the benefit which is attributable to the amount excludable under section 101(a).

§ 1.408-4 Treatment of distributions from individual retirement arrangements.

(a) General rule-(a)(1) Inclusion in income. Except as otherwise provided in this section, any amount actually paid or distributed or deemed paid or distributed from an individual retirement account or individual retirement annuity shall be included in the gross income of the payee or distributee for the taxable year in which the payment or distribution is received.

(a)(2) Zero basis. Notwithstanding section 1015(d) or any other provision of the Code, the basis (or investment in the contract) of any person in such an *52794 account or annuity is zero. For purposes of this section, an assignment of an individual's rights under an individual retirement account or an individual retirement annuity shall, except as provided in § 1.408-4(g) (relating to transfer incident to divorce), be deemed a distribution to such individual from such account or annuity of the amount assigned.

(b) Rollover contribution-(b)(1) To individual retirement arrangement. Paragraph (a)(1) of this section shall not apply to any amount paid or distributed from an individual retirement account or individual retirement annuity to the individual for whose benefit the account was established or who is the owner of the annuity if the entire amount received (including the same amount of money and any other property) is paid into an individual retirement account, annuity (other than an endowment contract), or bond created for the benefit of such individual not later than the 60th day after the day on which he receives the payment or distribution.

(b)(2) To qualified plan. Paragraph (a)(1) of this section does not apply to any amount paid or distributed from an individual retirement account or individual retirement annuity to the individual for whose benefit the account was established or who is the owner of the annuity if-

(b)(2)(i) No amount in the account or no part of the value of the annuity is attributable to any source other than a rollover contribution from an employees' trust described in section 401(a) which is exempt from tax under section 501(a) or a rollover contribution from an annuity plan described in section 403(a) and the earnings on such sums, and

(b)(2)(ii) The entire amount received (including the same amount of money and any other property) represents the entire amount in the account and is paid into another such trust or plan

(for the benefit of such individual) not later than the 60th day after the day on which the payment or distribution is received.

This subparagraph does not apply if any portion of the rollover contribution described in paragraph (b)(2)(i) of this section is attributable to an employees' trust forming part of a plan or an annuity under which the individual was an employee within the meaning of section 401(c)(1) at the time contributions were made on his behalf under the plan.

(b)(3) To section 403(b) contract. [Reserved]

(b)(4) Frequency limitation. (i) For taxable years beginning on or before December 31, 1977, paragraph (b)(1) of this section does not apply to any amount received by an individual from an individual retirement account, annuity or bond if at any time during the 3-year period ending on the day of receipt, the individual received any other amount from an individual retirement account, annuity or bond which was not includible in his gross income because of the application of paragraph (b)(1) of this section.

(ii) [Reserved]

(c) Excess contributions returned before due date of return-(c)(1) Excess contribution. For purposes of this paragraph, excess contributions are the excess of the amounts contributed to an individual retirement account or paid for an individual retirement annuity during the taxable year over the amount allowable as a deduction under section 219 or 220 for the taxable year.

(c)(2) General rule. (i) Paragraph (a)(1) of this section does not apply to the distribution of any excess contribution paid during a taxable year to an account or annuity if: the distribution is received on or before the date prescribed by law (including extensions) for filing the individual's return for such taxable year; no deduction is allowed under section 219 or section 220 with respect to the excess contribution; and the distribution is accompanied by the amount of net income attributable to the excess contribution as of the date of the distribution as determined under subdivision (ii).

(ii) The amount of net income attributable to the excess contributions is an amount which bears the same ratio to the net income earned by the account during the computation period as the excess contribution bears to the sum of the balance of the account as of the first day of the taxable year in which the excess contribution is made and the total contribution made for such taxable year. For purposes of this paragraph, the term "computation period" means the period beginning on the first day of the taxable year in which the excess contribution is made and ending on the date of the distribution from the account.

(ii)(iii) For purposes of paragraph (c)(2)(ii), the net income earned by the account during the computation period is the fair market value of the balance of the account immediately after the distribution increased by the amount of distributions from the account during the computation period, and reduced (but not below zero) by the sum of: (A) the fair market value of the balance of the account as of the first day of the taxable year in which the excess contribution is made and (B) the contributions to the account made during the computation period.

(ii)(iii)(3) Time of inclusion. (i) For taxable years beginning before January 1, 1977, the amount of net income determined under subparagraph (2) is includible in the gross income of the

individual for the taxable year in which it is received. The amount of net income thus distributed is subject to the tax imposed by section 408(f)(1) for the year includible in gross income.

(ii)(ii) [Reserved]

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

Example. On January 1, 1975, A, age 55, who is a calendar-year taxpayer, contributes \$1,500 to an individual retirement account established for his benefit. For 1975, A is entitled to a deduction of \$1,400 under section 219. For 1975, A does not claim as deductions any other items listed in section 62. A's gross income for 1975 is \$9,334. On April 1, 1976, \$107 is distributed to A from his individual retirement account. As of such date, the balance of the account is \$1,498 [\$1,605 - \$107]. There were no other distributions from the account as of such date. The net amount of income earned by the account is \$105 [\$1,498 + \$107 - (0 + \$1,500)]. The net income attributable to the excess contribution is \$7. [$\$105 \times (\$100/\$1,500)$]. A's adjusted gross income for 1975 is his gross income for 1975 (\$9,334) reduced by the amount allowable to A as a deduction under section 219 (\$1,400), or \$7,934. A will include the \$7 of the \$107 distributed on April 1, 1976, in his gross income for 1976. Further, A will pay an additional income tax of \$.70 for 1976 under section 408(f)(1).

(d) Deemed distribution-(d)(1) General rule. In any case in which an individual retirement account ceases to be an individual retirement account by reason of the application of section 408(e)(2), paragraph (a)(1) of this section shall apply as if there were a distribution on the first day of the taxable year in which such account ceases to be an individual retirement account of an amount equal to the fair market value on such day of all of the assets in the account on such day. In the case of a deemed distribution from an individual retirement annuity, see § 1.408-3(d).

(d)(2) Using account as security. In any case in which an individual for whose benefit an individual retirement account is established uses, directly or indirectly, all or any portion of the account as security for a loan, paragraph (a)(1) of this section shall apply as if there were distributed on the first day of the taxable year in which the loan was made an amount equal to that portion of the account used as security for such loan.

(e) Distribution of annuity contracts. Paragraph (a)(1) of this section does not apply to any annuity contract which is distributed from an individual *52795 retirement account and which satisfies the requirements of paragraphs (b) (1), (3), (4) and (5) of section 408. Amounts distributed under such contracts will be taxable to the distributee under section 72. For purposes of applying section 72 to a distribution from such a contract, the investment in such contract is zero.

(f) Treatment of assets distributed from an individual retirement account for the purchase of an endowment contract. Under section 408(e)(5), if all, or any portion, of the assets of an individual retirement account are used to purchase an endowment contract described in § 1.408-3(e) for the benefit of the individual for whose benefit the account is established-

(f)(1) The excess, if any, of the total amount of assets used to purchase such contract over the portion of the assets attributable to life insurance protection shall be treated as a rollover contribution described in section 408(d)(3), and

(f)(2) The portion of the assets attributable to life insurance protection shall be treated as a distribution described in paragraph (a)(91) of this section, except that the provisions of section 408(f) shall not apply to such amount.

(g) Transfer incident to divorce-(g)(1) General rule. The transfer of an individual's interest, in whole or in part, in an individual retirement account, individual retirement annuity, or a retirement bond, to his former spouse under a valid divorce decree or a written instrument incident to such divorce shall not be considered to be a distribution from such an account or annuity to such individual or his former spouse; nor shall it be considered a taxable transfer by such individual to his former spouse notwithstanding any other provision of Subtitle A of the Code.

(g)(2) Spousal account. The interest described in this paragraph (g) which is transferred to the former spouse shall be treated as an individual retirement account of such spouse if the interest is an individual retirement account; an individual retirement annuity of such spouse if such interest is an individual retirement annuity; and a retirement bond of such spouse if such interest is a retirement bond.

§ 1.408-5 Annual reports by trustees or issuers.

(a) In general. The trustee of an individual retirement account or the issuer of an individual retirement annuity shall make annual calendar year reports concerning the status of the account or annuity. The report shall contain the information required in paragraph (b) and be furnished or filed in the manner and time specified in paragraph (c).

(b) Information required to be included in the annual reports. The annual calendar year report shall contain the following information for transactions occurring during the calendar year-

(b)(1) The amount of contributions;

(b)(2) The amount of distributions;

(b)(3) In the case of an endowment contract, the amount of the premium paid allocable to the cost of life insurance;

(b)(4) The name and address of the trustee or issuer; and

(b)(5) Such other information as the Commissioner may require.

(c) Manner and time for filing. (1) The annual report shall be furnished to the individual on whose behalf the account is established or in whose name the annuity is purchased (or the beneficiary of the individual or owner). The report shall be furnished on or before the 30th day of June following the calendar year for which the report is required.

(c)(2) The Commissioner may require the annual report to be filed with the Service at the time the Commissioner specifies.

(d) Penalties. Section 6693 prescribes penalties for failure to file the annual report.

(e) Effective date. This section shall apply to reports for calendar years after 1978.

(f) Reports for years prior to 1979. For years prior to 1979, a trustee or issuer shall make reports in the time and manner as the Commissioner requires.

§ 1.408-6 Disclosure statements for individual retirement arrangements.

(a) In general-(a)(1) General rule. Trustees and issuers of individual retirement accounts and annuities are, under the authority of section 408 (i), required to provide disclosure statements. This section sets forth these requirements.

(a)(2) [Reserved]

(b) [Reserved]

(c) [Reserved]

(d) Requirements. (1) [Reserved]

(d)(2) [Reserved]

(d)(3) [Reserved]

(d)(4) Disclosure statements-(d)(4)(i) Under the authority contained in section 408(i), a disclosure statement shall be furnished in accordance with the provisions of this subparagraph by the trustee of an individual retirement account described in section 408(a) or the issuer of an individual retirement annuity described in section 408(b) or of an endowment contract described in section 408(b) to the individual (hereinafter referred to as the "benefited individual") for whom such an account, annuity, or contract is, or is to be, established.

(d)(4)(ii)(A)(1) The trustee or issuer shall furnish, or cause to be furnished, to the benefited individual, a disclosure statement satisfying the requirements of subdivisions (iii) through (viii) of this subparagraph, as applicable, and a copy of the governing instrument to be used in establishing the account, annuity, or endowment contract. The copy of such governing instrument need not be filled in with financial and other data pertaining to the benefited individual; however, such copy must be complete in all other respects. The disclosure statement and copy of the governing instrument must be received by the benefited individual at least seven days preceding the earlier of the date of establishment or purchase of the account, annuity, or endowment contract. A disclosure statement or copy of the governing instrument required by this subparagraph may be received by the benefited individual less than seven days preceding, but no later than, the earlier of the date of establishment or purchase, if the benefited individual is permitted to revoke the account, annuity, or endowment contract pursuant to a procedure which satisfies the requirements of subdivision (ii)(A)(2) of this subparagraph.

(d)(4)(ii)(A)(2) A procedure for revocation satisfies the requirements of this subdivision (ii)(A)(2) of this subparagraph if the benefited individual is permitted to revoke the account, or endowment contract by mailing or delivering, at his option, a notice of revocation on or before a day not less than seven days after the earlier of the date of establishment or purchase and, upon revocation, is entitled to a return of the entire amount of the consideration paid by him for the

account, annuity, or endowment contract without adjustment for such items as sales commissions, administrative expenses or fluctuation in market value. The procedure may require that the notice be in writing or that it be oral, or it may require both a written and an oral notice. If an oral notice is required or permitted, the procedure must permit it to be delivered by telephone call during normal business hours. If a written notice is required or permitted, the procedure must provide that, if mailed, it shall be deemed mailed on the date of the postmark (or if sent by certified or registered mail, the date of certification or registration) if it is deposited in the mail in the United States in an envelope, *52796 or other appropriate wrapper, first class postage prepaid, properly addressed.

(d)(4)(ii)(B) If after a disclosure statement has been furnished, or caused to be furnished, to the benefited individual pursuant to paragraph (d)(4)(ii)(A) of this section and-

(1) On or before the earlier of the date of establishment or purchase, or

(2) On or before the last day on which the benefited individual is permitted to revoke the account, annuity, or endowment contract (if the benefited individual has a right to revoke the account, annuity, or endowment contract pursuant to the rules of subdivision (ii)(A) of this subparagraph).

there becomes effective a material adverse change in the information set forth in such disclosure statement or a material change in the governing instrument to be used in establishing the account, annuity, or contract, the trustee or issuer shall furnish, or cause to be furnished, to the benefited individual such amendments to any previously furnished disclosure statement or governing instrument as may be necessary to adequately inform the benefited individual of such change. The trustee or issuer shall be treated as satisfying this subdivision (ii)(B) of this subparagraph only if material required to be furnished by this subdivision is received by the benefited individual at least seven days preceding the earlier of the date of establishment or purchase of the account, annuity, or endowment contract or if the benefited individual is permitted to revoke the account, annuity, or endowment contract on or before a date not less than seven days after the date on which such material is received, pursuant to a procedure for revocation otherwise satisfying the provisions of subdivision (ii)(A)(2) of this subparagraph.

(d)(4)(ii)(C) If the governing instrument is amended after the account, annuity, or endowment contract is no longer subject to revocation pursuant to subdivision (ii)(A) or (B) of this subparagraph, the trustee or issuer shall not later than the 30th day after the later of the date on which the amendment is adopted or becomes effective, deliver or mail to the last known address of the benefited individual a copy of such amendment and, if such amendment affects a matter described in subdivisions (iii) through (viii) of this subparagraph, a disclosure statement with respect to such matter meeting the requirements of subdivision (iv) of this subparagraph.

(d)(4)(ii)(D) For purposes of subdivision (ii) (A) and (B) of this subparagraph, if a disclosure statement, governing instrument, or an amendment to either, is mailed to the benefited individual, it shall be deemed (in the absence of evidence to the contrary) to be received by the benefited individual seven days after the date of mailing.

(d)(4)(ii)(E) In the case of a trust described in section 408(c) (relating to certain retirement savings arrangements for employees or members of associations of employees), the following special rules shall be applied:

(1) For purposes of this subparagraph, references to the benefited individual's account, annuity, or endowment contract shall refer to the benefited individual's interest in such trust, and

(2) The provisions of subdivision (ii) of this subparagraph shall be applied by substituting "the date on which the benefited individual's interest in such trust commences" for "the earlier of the date of establishment or purchase" wherever it appear therein.

Thus, for example, if an employer establishes a trust described in section 408(c) for the benefit of employees, and the trustee furnishes an employee with a disclosure statement and a copy of the governing instrument (as required by this subparagraph) on the date such employee's interest in the trust commences, such employee must be given a right to revoke such interest within a period of at least seven days. If any contribution has been made within such period (whether by the employee or by the employer), the full amount of such contribution must be paid to such employee pursuant to subdivision (ii)(A)(2) of this subparagraph.

(d)(4)(iii) The disclosure statement required by this subparagraph shall set forth in nontechnical language the following matters as such matters relate to the account, annuity, or endowment contract (as the case may be);

(d)(4)(iii)(A) Concise explanations of-

(1) The statutory requirements prescribed in section 408(a) (relating to an individual retirement account) or section 408(b) (relating to an individual retirement annuity and an endowment contract), and any additional requirements (whether or not required by law) that pertain to the particular retirement savings arrangement.

(2) The income tax consequences of establishing an account, annuity, or endowment contract (as the case may be) which meets the requirements of section 408(a) relating to an individual retirement account) or section 408(b) (relating to an individual retirement annuity and an endowment contract), including the deductibility of contributions to, the tax treatment of distributions (other than premature distributions) from, the availability of income tax free rollovers to and from, and the tax status of such account, annuity, or endowment contract.

(3) The limitations and restrictions on the deduction for retirement savings under section 219, including the ineligibility of certain individuals who are active participants in a plan described in section 219(b)(2)(A) or for whom amounts are contributed under a contract described in section 219(b)(2)(B) to make deductible contributions to an account or for an annuity or endowment contract.

(4) The circumstances under which the benefited individual may revoke the account, annuity, or endowment contract, and the procedure therefor (including the name, address, and telephone number of the person designated to receive notice of such revocation). Such explanation shall be prominently displayed at the beginning of the disclosure statement.

(d)(4)(iii)(B) Statements to the effect that-

(1) If the benefited individual or his beneficiary engages in a prohibited transaction, described in section 4975(c) with respect to an individual retirement account, the account will lose its exemption from tax by reason of section 408(e)(2)(A), and the benefited individual must include

in gross income, for the taxable year during which the benefited individual or his beneficiary engages in the prohibited transaction the fair market value of the account.

(2) If the owner of an individual retirement annuity or endowment contract described in section 408(b) borrows any money under, or by use of, such annuity or endowment contract, then, under section 408(e)(3), such annuity or endowment contract loses its section 408(b) classification, and the owner must include in gross income, for the taxable year during which the owner borrows any money under, or by use of, such annuity or endowment contract, the fair market value of the annuity or endowment contract.

(3) If a benefited individual uses all or any portion of an individual retirement account as security for a loan, then, under section 408(e)(4), the portion so used is treated as distributed to such individual and the benefited individual must include such distribution in gross income for the taxable year during which he so uses such account.

(4) An additional tax of 10 percent is imposed by section 408(f) on distributions (including amounts deemed distributed as the result of a prohibited loan or use as security for a loan) made before the benefited individual has attained age 59 1/2, unless such distribution is made on account of death or disability, or unless a rollover *52797 contribution is made with such distribution.

(5) Sections 2039(e) (relating to exemption from estate tax of annuities under certain trusts and plans) and 2517 (relating to exemption from gift tax of specified transfers of certain annuities under qualified plans) apply (including the manner in which such sections apply) to the account, annuity, or endowment contract.

(6) Section 402(a)(2) and (e) (relating to tax on lump sum distributions) is not applicable to distributions from an account, annuity, or endowment contract.

(7) A minimum distribution is required under section 408(a) (6) or (7) and 408(b) (3) or (4) (including a brief explanation of the amount of minimum distribution) and that if the amount distributed from an account, annuity, or endowment contract during the taxable year of the payee is less than the minimum required during such year, an excise tax, which shall be paid by the payee, is imposed under section 4974, in an amount equal to 50 percent of the excess of the minimum required to be distributed over the amount actually distributed during the year.

(8) An excise tax is imposed under section 4973 on excess contributions (including a brief explanation of an excess contribution).

(9) The benefited individual must file Form 5329 (Return for Individual Retirement Savings Arrangement) with the Internal Revenue for each taxable year during which the account, annuity, or endowment contract is maintained.

(10) The account or contract has or has not (as the case may be) been approved as to form for use as an account, annuity, or endowment contract by the Internal Revenue Service. For purposes of this subdivision, if a favorable opinion or determination letter with respect to the form of a prototype trust, custodial account, annuity, or endowment contract has been issued by the Internal Revenue Service, or the instrument which establishes an individual retirement trust account or an individual retirement custodial account utilizes the precise language of a form

currently provided by the Internal Revenue Service (including any additional language permitted by such form), such account or contract may be treated as approved as to form.

(11) The Internal Revenue Service approval is a determination only as to the form of the account, annuity, or endowment contract, and does not represent a determination of the merits of such account, annuity, or endowment contract.

(12) The proceeds from the account, annuity or endowment contract may be used by the benefited individual as a rollover contribution to another account or annuity or retirement bond in accordance with the provisions of section 408(d)(3).

(13) In the case of an endowment contract described in section 408(b), no deduction is allowed under section 219 for that portion of the amounts paid under the contract for the taxable year properly allocable to the cost of life insurance.

(14) If applicable, in the event that the benefited individual revokes the account, annuity, or endowment contract, pursuant to the procedure described in the disclosure statement (see subdivision (A)(4) of this subdivision (iii)), the benefited individual is entitled to a return of the entire amount of the consideration paid by him for the account, annuity, or endowment contract without adjustment for such items as sales commissions, administrative expenses or fluctuation in market value.

(15) Further information can be obtained from any district office of the Internal Revenue Service.

To the extent that information on the matters described in subdivisions (iii) (A) and (B) of this subparagraph is provided in a publication of the Internal Revenue Service relating to individual retirement savings arrangements, such publication may be furnished by the trustee or issuer in lieu of providing information relating to such matters in a disclosure statement.

(d)(4)(iii)(C) The financial disclosure required by paragraph (d)(4) (v), (vi), and (vii) of this section.

(d)(4)(iv) In the case of an amendment to the terms of an account, annuity, or endowment contract described in paragraph (d)(4)(i) of this section, the disclosure statement required by this subparagraph need not repeat material contained in the statement furnished pursuant to paragraph (d)(4)(iii) of this section, but it must set forth in nontechnical language those matters described in paragraph (d)(4)(iii) of this section which are affected by such amendment.

(d)(4)(v) With respect to an account, annuity, or endowment contract described in paragraph (d)(4)(i) of this section (other than an account or annuity which is to receive only a rollover contribution described in paragraph (d)(4)(vi) of this section and to which no deductible contributions will be made), the disclosure statement must set forth in cases where either an amount is guaranteed over period of time (such as in the case of a nonparticipating endowment or annuity contract), or a projection of growth of the value of the account, annuity, or endowment contract can reasonably be made (such as in the case of a participating endowment or annuity contract (other than a variable annuity) or passbook savings account), the following:

(d)(4)(v)(A) To the extent that an amount is guaranteed,

(1) The amount, determined without regard to any portion of a contribution which is not deductible, that would be guaranteed to be available to the benefited individual if (i) level annual contributions in the amount of \$1,000 were to be made on the first day of each year, and (ii) the benefited individual were to withdraw in a single sum the entire amount of such account, annuity, or endowment contract at the end of each of the first five years during which contributions are to be made, at the end of the year in which the benefited individual attains the ages of 60, 65, and 70, and at the end of any other year during which the increase of the guaranteed available amount is less than the increase of the guaranteed available amount during any preceding year for any reason other than decrease of cessation of contributions, and

(2) A statement that the amount described in subdivision (v)(A)(1) of this subparagraph is guaranteed, and the period for which guaranteed;

(d)(4)(v)(B) To the extent a projection of growth of the value of the account, annuity, or endowment contract can reasonably be made but the amounts are not guaranteed.

(1) The amount, determined without regard to any portion of a contribution which is not deductible, and upon the basis of an earnings rate no greater than, and terms no different from, those currently in effect, that would be available to the benefited individual if (i) level annual contributions in the amount of \$1,000 were to be made on the first day of each year, and (ii) the benefited individual were to withdraw in a single sum the entire amount of such account, annuity, or endowment contract at the end of each of the first five years during which contributions are to be made, at the end of each of the years in which the benefited individual attains the ages of 60, 65, and 70, and at the end of any other year during which the increase of the available amount is less than the increase of the available amount during any preceding year for any reason other than decrease or cessation of contributions, and

(2) A statement that the amount described in paragraph (d)(4)(v)(B)(1) of this section is a projection and is not *52798 guaranteed and a statement of the earnings rate and terms on the basis of which the projection is made;

(d)(4)(v)(C) The portion of each \$1,000 contribution attributable to the cost of life insurance, which would not be deductible, for each year during which contributions are to be made; and

(d)(4)(v)(D) The sales commission (including any commission attributable to the sale of life insurance), if any, to be charged in each year, expressed as a percentage of gross annual contributions (including any portion attributable to the cost of life insurance) to be made for each year.

(d)(4)(vi) With respect to an account or annuity described in paragraph (d)(4)(i) of this section to which a rollover contribution described in section 402(a)(5)(A), 403(a)(4)(A), 408(d)(3)(A) or 409(b)(3)(C) will be made, the disclosure statement must set forth, in cases where an amount is guaranteed over a period of time (such as in the case of a non-participating annuity contract, or a projection of growth of the value of the account or annuity can reasonably be made (such as in the case of a participating annuity contract (other than a variable annuity) or a passbook savings account), the following:

(d)(4)(vi)(A) To the extent guaranteed,

(d)(4)(vi)(A)(1) The amount that would be guaranteed to be available to the benefited individual if (i) Such a rollover contribution in the amount of \$1,000 were to be made on the first day of the year, (ii) No other contribution were to be made, and (iii) The benefited individual were to withdraw in a single sum the entire amount of such account or annuity at the end of each of the first five years after the contribution is made, at the end of the year in which the benefited individual attains the ages of 60, 65, and 70, and at the end of any other year during which the increase of the guaranteed available amount is less than the increase of the guaranteed available amount during any preceding year, and

(d)(4)(vi)(A)(2) A statement that the amount described in paragraph (d)(vi)(A)(1) of this section is guaranteed;

(d)(4)(vi)(B) To the extent that a projection of growth of the value of the account or annuity can reasonably be made but the amounts are not guaranteed,

(d)(4)(vi)(B)(1) The amount, determined upon the basis of an earnings rate no greater than, and terms no different from, those currently in effect, that would be available to the benefited individual if (i) such a rollover contribution in the amount of \$1,000 were to be made on the first day of the year, (ii) no other contribution were to be made, and (iii) the benefited individual were to withdraw in a single sum the entire amount of such account or annuity at the end of each of the first five years after the contribution is made, at the end of each of the years in which the benefited individual attains the ages 60, 65, 70, and at the end of any other year during which the increase of the available amount is less than the increase of the available amount during any preceding year, and

(d)(4)(vi)(B)(2) A statement that the amount described in paragraph (d)(4)(vi)(B) (1) of this section is a projection and is not guaranteed and a statement of the earnings rate and terms on the basis of which the projection is made; and

(d)(4)(vi)(C) The sales commission, if any, to be charged in each year, expressed as a percentage of the assumed \$1,000 contribution.

(d)(4)(vii) With respect to an account, annuity, or endowment contract described in paragraph (d)(4)(i) of this section, in all cases not subject to paragraph (d)(4) (v) or (vi) of this section (such as in the case of a mutual fund or variable annuity), the disclosure statement must set forth information described in subdivisions (A) through (C) of this subdivisions (vii) based (as applicable with respect to the type or types of contributions to be received by the account, annuity, or endowment contract) upon the assumption of (1) level annual contributions of \$1,000 on the first day of each year, (2) a rollover contribution of \$1,000 on the first day of the year and no other contributions, or (3) a rollover contribution of \$1,000 on the first day of the year plus level annual contributions of \$1,000 on the first day of each year.

(d)(4)(vii)(A) A description (in nontechnical language) with respect to the benefited individual's interest in the account, annuity, or endowment contract, of:

(d)(4)(vii)(A)(1) Each type of charge, and the amount thereof, which may be made against a contribution,

(d)(4)(vii)(A)(2) The method for computing and allocating annual earnings, and

(3) Each charge (other than those described in complying with paragraph (d)(4)(vii)(A)(1) of this section) which may be applied to such interest in determining the net amount of money available to the benefited individual and the method of computing each such charge;

(d)(4)(vii)(B) A statement that growth in value of the account, annuity, or endowment contract is neither guaranteed nor projected; and

(d)(4)(vii)(C) The portion of each \$1,000 contribution attributable to the cost of life insurance, which would not be deductible, for every year during which contributions are to be made.

(d)(4)(viii) A disclosure statement, or an amendment thereto, furnished pursuant to the provisions of this subparagraph may contain information in addition to that required by paragraph (d)(4)(iii) through (vii) of this section. However, such disclosure statement will not be considered to comply with the provisions of this subparagraph if the substance of such additional material or the form in which it is presented causes such disclosure statement to be false or misleading with respect to the information required to be disclosed by this paragraph.

(d)(4)(ix) The provisions of section 6693, relating to failure to provide reports on individual retirement accounts or annuities, shall apply to any trustee or issuer who fails to furnish, or cause to be furnished, a disclosure statement, a copy of the governing instrument, or an amendment to either, as required by this paragraph.

(d)(4)(x) This section shall be effective for disclosure statements and copies of governing instruments mailed, or delivered without mailing, after February 14, 1977.

(d)(4)(xi) This section does not reflect the amendments made by section 1501 of the Tax Reform Act of 1976 (90 Stat. 1734) relating to retirement savings for certain married individuals.

§ 1.408-7 Reports on distributions from individual retirement plans.

(a) Requirement of report. The trustee of an individual retirement account or the issuer of an individual retirement annuity who makes a distribution during any calendar year to an individual from such account or under such annuity shall make a report on Form W-2P (in the case of distributions that are not total distributions) or Form 1099R (in the case of total distributions), and their related transmittal forms, for such year. The return must show the name and address of the person to whom the distribution was made, the aggregate amount of such distribution, and such other information as is required by the forms.

(b) Amount subject to this section. The amounts subject to reporting under paragraph (a) include all amounts distributed or made available to which section 408(d) applies.

(c) Time and place for filing. The report required under this section for any calendar year shall be filed after the close of that year and on or before February 28 of the following year with the appropriate Internal Revenue Service Center.

(d) Statement to recipients. (1) Each trustee or issuer required to file Form 1099R or Form W-2P under this section *52799 shall furnish to the person whose identifying number is (or should be) shown on the forms a copy of the form.

(d)(2) Each statement required by this paragraph to be furnished to recipients shall be furnished to such person after November 30 of the year of the distribution and on or before January 31 of the following year.

(e) Effective date. This section is effective for calendar years beginning after December 31, 1977.

Par. 3. The following new section is added immediately after § 1.408-7:

§ 1.409-1 Retirement bonds.

(a) In general. Section 409 authorizes the issuance of bonds under the Second Liberty Bond Act the purchase price of which would be deductible under section 219. Section 409 also prescribes the tax treatment of such bonds. See paragraph (b) of this section.

(b) Income tax treatment of bonds-(b)(1) General rule. Except as provided in paragraph (b)(2) of this section, the entire proceeds upon redemption of a retirement bond described in section 409 (a) shall be included in the gross income of the taxpayer entitled to such proceeds. If a bond has not been tendered for redemption by the registered owner before the close of the taxable year in which he attains age 70 1/2, he must include in his gross income for such taxable year the amount of the proceeds he would have received if the bond had been redeemed at age 70 1/2. The provisions of sections 72 and 1232 do not apply to a retirement bond.

(b)(2) Exceptions. (i) If a retirement bond is redeemed within 12 months after the issue date, the proceeds are excluded from gross income if no deduction is allowed under section 219 on account of the purchase of such bond. For definition of issue date, see 31 CFR 346.1(c).

(ii) If a retirement bond is redeemed after the close of the taxable year in which the registered owner attains age 70 1/2 the proceeds from the redemption of the bond are excludable from the gross income of the registered owner or his beneficiary to the extent that such proceeds were includible in the gross income of the registered owner for such taxable year.

(ii)(iii) If a retirement bond is surrendered for reissuance in the same or lesser face amount, the difference between current redemption value of the bond surrendered for reissuance and the current surrender value of the bond reissued is includible in the gross income of the registered owner.

(ii)(iii)(3) Basis. The basis of a retirement bond is zero.

(c) Rollover. The first sentence of paragraph (b)(1) of this section shall not apply in any case in which a retirement bond is redeemed by the registered owner before the close of the taxable year in which he attains the age of 70 1/2 if he transfers the entire amount of the proceeds of such redemption to-

(c)(1) An individual retirement account described in section 408(a) or an individual retirement annuity described in section 408(b) (other than an endowment contract described in § 1.408-3(e)), or

(c)(2) An employees' trust which is described in section 401(a) which is exempt from tax under section 501(a), or an annuity plan described in section 403(a), for the benefit of the registered owner, on or before the 60th day after the day on which he received the proceeds of such redemption. This subparagraph shall not apply in the case of a transfer to a trust or plan described in (c)(2) of this section unless no part of the purchase price of the retirement bond redeemed is attributable to any source other than a rollover contribution from such an employees' trust or annuity plan (other than an annuity plan or employees' trust forming part of a plan under which the individual was an employee within the meaning of section 401(c)(1) at the time contributions were made on his behalf under the plan).

(d) Additional tax. (1) Early redemption. Except as provided in paragraph (d)(2) of this section, under section 409(c) if a retirement bond is redeemed by the registered owner before he attains age 59 1/2, his tax under chapter 1 of the Code is increased by an amount equal to 10 percent of the proceeds of the redemption includible in his gross income for the taxable year. Except in the case of the credits allowable under sections 31, 39, or 42, no credit can be used to offset the tax described in the preceding sentence.

(d)(2) Limitations. Paragraph (d)(1) of this section shall not apply if-

(d)(2)(i) During the taxable year of the registered owner in which a retirement bond is redeemed, the registered owner becomes disabled within the meaning of section 72(m)(7), or

(d)(2)(ii) A retirement bond is tendered for redemption in accordance with paragraph (b)(2)(i) of this section.

PART 54-PENSION EXCISE TAXES

Par. 4. The following new section is added immediately after § 53.4952-1:

§ 54.4974-1 Excise tax on accumulations in individual retirement accounts or annuities.

(a) General rule. A tax equal to 50 percent of the amount by which the minimum amount required to be distributed from an individual retirement account or annuity described in section 408 during the taxable year of the payee under paragraph (b) of this section exceeds the amount actually distributed during the taxable year is imposed by section 4974 on the payee.

(b) Minimum amount required to be distributed. For purposes of this section, the minimum amount required to be distributed is the amount required under § 1.408-2(b)(6)(v) to be distributed in the taxable year described in paragraph (a) of this section.

(c) Examples. The application of this section may be illustrated by the following examples.

Example (1). In 1975, the minimum amount required to be distributed under § 1.408-2(b)(6)(v) to A under his individual retirement account is \$100. Only \$60 is actually distributed to A in 1975. Under section 4974, A would have an excise tax liability of \$20 [50% of (\$100-\$60)].

Example (2). Although no distribution is required under § 1.408-2(b)(6)(v) to be made in 1986, H, a married individual born on February 1, 1921, who has established and maintained an individual retirement account decides to begin receiving distributions from the account

beginning in 1986. H's wife, W, was born on March 6, 1921. H and W are calendar year taxpayers. H decides to receive his interest in the account over the joint life and last survivor expectancy of himself and his wife. On January 1, 1986, the balance in H's account is \$10,000; H and W, based on their nearest birthdates, are 65; and the joint life and last survivor expectancy of H and his wife is 22.0 years (see Table II of § 1.72-9). His annual payments during the following years (none of which were required) were determined by dividing the balance in the account on the first day of each year by the joint life and last survivor expectancy reduced by the number of whole years elapsed since the distributions were to commence.

For 1986, 1987, 1989, and 1990, the amount required to be distributed under § 1.408-2(b)(6)(v) is zero. *52800 Thus, H would have no excise tax liability under section 4974 for these years. In 1991, the year H attains age 70 1/2, the amount required to be distributed from the account under § 1.408-2(b)(6)(v) is \$565, determined by dividing \$10,340 (the account balance as of January 1, 1991) by 18.8 years (the joint life and last survivor expectancy of H and W, assuming they are both still living, as of January 1, 1991). If W should die after December 31, 1990, the joint life and last survivor expectancy determined on January 1, 1991 (18.3 years) would not be redetermined. Because the amount distributed from the account in 1991 (\$608) exceeds the amount required to be distributed from the account in 1991 (\$565), H has no excise tax liability under section 4974 for 1991.

Example (3). Assume the same facts as in example (2) except that W dies in 1988. For 1988, 1989, and 1990, the amount required to be distributed under § 1.408-2(b)(6)(v) is zero. Thus, H would have no excise tax liability under section 4974 for these years. In 1991, the amount required to be distributed under § 1.408-2(b)(6)(v) is \$855, determined by dividing \$10,340 (the account balance as of January 1, 1991) by 12.1 years (the life expectancy of H as of January 1, 1991). Because the amount distributed from the account in 1991 (\$608) is less than the amount required to be distributed from the account in 1991 (\$855), H has an excise tax liability of \$123.50 under section 4974 for 1991 [50% of (\$855-\$608)].

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