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Pension and Annuity Income

(Including Simplified General Rule)

For use in preparing

1996 Returns

Contents

Important Changes for 1996

Annuity payments from qualified plans. If your annuity starting date is ***after November 18, 1996,*** you must use a modified method to figure your taxable pension for the year under the Simplified General Rule. The new law changed the recovery factors (anticipated monthly payments) used to figure the tax-free portion of your annuity from a qualified plan. The General Rule can no longer be used for qualified plans. The revised amounts are:

- 360 (from 300), if annuitant is age 55 or under.
- 310 (from 260), if annuitant is over age 55 but not more than 60.

- 260 (from 240), if annuitant is over age 60 but not more than 65.
- 210 (from 170), if annuitant is over age 65 but not more than 70.
- 160 (from 120), if annuitant is over age 70. The new law does not apply if you are age 75 or over on the annuity starting date unless there are fewer than 5 years of guaranteed annuity payments.

The Simplified General Rule is discussed under *Taxation of Periodic Payments.*

Repeal of $5,000 death benefit exclusion. The new law repeals the $5,000 exclusion for employer-provided death benefits. If an employee dies ***after August 20, 1996,*** the estate or his or her beneficiary can no longer exclude from income up to $5,000 in benefits paid by or on behalf of an employer because of the employee's death.

Important Changes for 1997

Minimum required distribution rule modified. ***Beginning in 1997***, the new law modifies the definition of the required beginning date that is used to figure the minimum required distribution from qualified retirement plans. Under the new law, the required beginning date of a participant who is still employed after age 70 ½ is April 1 of the calendar year that follows the calendar year in which he or she retires. The new law does not extend the new provisions to IRAs. As discussed in this publication under *Tax on Excess Accumulation,* for years prior to 1997, all participants in qualified plans and IRAs must start distributions by April 1 of the year following the calendar year in which he or she reaches age 70 ½.

Suspension of the 15% tax on excessive distributions. New law suspends the 15% excise tax on excessive distributions for distributions received ***after December 31, 1996*** and before January 1, 2000. As discussed in this publication under *Tax on Excess Distributions,* retirement distributions in excess of $155,000 are subject to a 15% excise tax on the amount over $155,000. The dollar limit that currently applies for lump-sum distributions is $775,000.

Repeal of SARSEPs and creation of new SIMPLE plan. After December 31, 1996, an employer will no longer be permitted to establish a Salary Reduction Simplified Employee Pension (SARSEP) plan. SARSEPs established before 1997 may continue receiving participant contributions; also, new employees of the employer hired will be allowed to participate in the SARSEP.

Beginning in 1997, the new law creates a SIMPLE Retirement plan for small employers. For more information on the new SIMPLE plan, get Publication 560.

Excise tax increase on prohibited transactions. Excise tax on prohibited transactions occurring ***after August 20, 1996*** increases from 5% to 10%.

Important Reminder

Individual Taxpayer Identification Number (ITIN). The IRS will issue an ITIN to a nonresident or resident alien who does not have and is not eligible to get a social security number (SSN). To apply for an ITIN, file Form W-7 with the IRS. It usually takes 30 days to get it. The ITIN is entered wherever an SSN is requested on a tax return.

An ITIN is for tax use only. It does not entitle the holder to social security benefits or change the holder's employment or immigration status under U.S. law.

Foreign source income. If you are a U.S. citizen with income from ***sources outside the United States (foreign income),*** you must report all such income on your tax return unless it is exempt by U.S. law. This is true whether you reside inside or outside the United States and whether or not you receive a Form W-2 or 1099 from the foreign payor. This applies to earned income (such as wages and tips) as well as unearned income (such as interest, dividends, capital gains, pensions, rents and royalties).

If you reside outside the United States, you may be able to exclude part or all of your foreign source earned income. For details, see Publication 54, *Tax Guide for U.S. Citizens and Resident Aliens Abroad.*

Introduction

This publication explains how to report pension and annuity income on your federal income tax return. It also covers the special tax treatment of lump-sum distributions from pension, stock bonus, and profit-sharing plans, and of rollovers from qualified employer plans.

If you are retired from the federal government (either regular or disability retirement), get Publication 721, *Tax Guide to U.S. Civil Service Retirement Benefits.* Also, you should get Publication 721 if you are the survivor or beneficiary of a federal employee or retiree who died.

If you participate in a nonqualified plan (such as a deferred compensation plan under section 457), this publication may not apply to you. These plans have special rules because they do not qualify for tax-favored status. State and local government agencies report a section 457 plan distribution to an employee on Form W-2 (not on Form 1099–R)

In explaining how to figure the taxable and nontaxable parts of annuity payments you receive, this publication covers only the Simplified General Rule.

If you must use the nonsimplified General Rule, you should get Publication 939, *Pension General Rule (Nonsimplified Method).* That publication gives you the information, including actuarial tables, that you need to figure the tax treatment of your payments.

If, after reading this publication and Publication 939, you cannot figure the taxable part of your pension or annuity, the IRS can do it for you for a fee. For information on this service, see *Requesting a Ruling on Taxation of Annuity,* in Publication 939.

You can also get help from the employee plans taxpayer assistance telephone service between the hours of 1:30 p.m. and 4 p.m. Eastern Time, Monday through Thursday, at (202) 622–6074/6075. These are not toll-free numbers.)

Useful Items

You may want to see:

Publication

- ☐ **524** Credit for the Elderly or the Disabled
- ☐ **525** Taxable and Nontaxable Income
- ☐ **560** Retirement Plans for the Self-Employed
- ☐ **571** Tax-Sheltered Annuity Programs for Employees of Public Schools and Certain Tax-Exempt Organizations
- ☐ **590** Individual Retirement Arrangements (IRAs)
- ☐ **721** Tax Guide to U.S. Civil Service Retirement Benefits
- ☐ **939** Pension General Rule (Nonsimplified Method)

Form (and Instructions)

- ☐ **1099–R** Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.
- ☐ **4972** Tax on Lump-Sum Distributions
- ☐ **5329** Additional Taxes Attributable to Qualified Retirement Plans (Including IRAs), Annuities, and Modified Endowment Contracts

See *How To Get More Information,* near the end of this publication for information about getting these publications and forms.

General Information

Some of the terms used in this publication are defined in the following paragraphs.

A **pension** is generally a series of payments made to you after you retire from work. Pension payments are made regularly and are for past services with an employer.

An **annuity** is a series of payments under a contract. You can buy the contract alone or you can buy it with the help of your employer. Annuity payments are made regularly for more than one full year.

A **qualified employee plan** is an employer's stock bonus, pension, or profit-sharing plan that is for the exclusive benefit of employees or their beneficiaries. This plan must meet Internal Revenue Code requirements. It qualifies for special tax benefits, including tax deferral for employer contributions and rollover distributions, and capital gain treatment or the 5– or 10–year tax option for lump-sum distributions.

A **qualified employee annuity** is a retirement annuity purchased by an employer for an employee under a plan that meets Internal Revenue Code requirements.

A **tax-sheltered annuity** is a special annuity contract purchased for an employee of a public school or tax-exempt organization.

A **nonqualified employee plan** is an employer's plan that does not meet Internal Revenue Code requirements. It does not qualify for most of the tax benefits of a qualified plan.

Particular types of pensions and annuities include:

1) **Fixed period annuities.** You receive definite amounts at regular intervals for a definite length of time.
2) **Annuities for a single life.** You receive definite amounts at regular intervals for life. The payments end at death.
3) **Joint and survivor annuities.** The first annuitant receives a definite amount at regular intervals for life. After he or she dies, a second annuitant receives a definite amount at regular intervals for life. The amount paid to the second annuitant may or may not differ from the amount paid to the first annuitant.
4) **Variable annuities.** You receive payments that may vary in amount for a definite length of time or for life. The amounts you receive may depend upon such variables as profits earned by the pension or annuity funds or cost-of-living indexes.
5) **Disability pensions.** You are under minimum retirement age and receive payments because you retired on disability.

More than one program. You may receive employee plan benefits from more than one program under a single trust or plan of your employer. If you participate in more than one program, you may have to treat each as a separate contract, depending upon the facts in each case. Also, you may be considered to have received more than one pension or annuity. Your former employer or the plan administrator should be able to tell you if you have more than one pension or annuity contract.

Example. Your employer, a corporation, set up a noncontributory ***profit-sharing plan*** for its employees. The plan provides that the amount held in the account of each participant will be paid at the time of that participant's retirement. Your employer also set up a contributory defined benefit ***pension plan*** for its employees providing for the payment of a lifetime pension to each participant after retirement.

The amount of any distribution from the profit-sharing plan depends on the contributions made for the participant and the earnings and additions (allocated forfeitures) on those contributions. Under the pension plan, however, a formula determines the amount of the pension. The amount of contributions is the amount necessary to provide that pension.

Each plan is a separate program and a separate contract. If you get benefits from these plans, you must account for each separately, even though the benefits from both may be included in the same check.

Qualified domestic relations order. A spouse or former spouse who receives part of the benefits from a retirement plan under a qualified domestic relations order (QDRO) reports the payments received as if he or she were a plan participant. The spouse or former spouse is allocated a share of the participant's cost (investment in the plan) equal to the cost times a fraction. The numerator (top part) of the fraction is the present value of the benefits payable to the spouse or former spouse. The denominator (bottom part) is the present value of all benefits payable for the participant.

A distribution that is paid to a child or dependent under a QDRO is taxed to the plan participant.

A QDRO is a judgment, decree, or order relating to payment of child support, alimony, or marital property rights to a spouse, former spouse, child, or other dependent. The order must contain certain specific information, such as the amount or percentage of the participant's benefits to be paid to each alternate payee. It may not award an amount or form of benefit that is not available under the plan.

Railroad Retirement

Benefits paid under the Railroad Retirement Act fall into two categories. These categories are treated differently for income tax purposes.

The **first category** is the amount of tier 1 railroad retirement benefits that equals the social security benefit that a railroad employee or beneficiary would have been entitled to receive under the social security system. This part of the tier 1 benefit is the ''Social Security Equivalent Benefit'' (SSEB) and you treat it for tax purposes like social security benefits. It is shown on Form RRB–1099, *PAYMENTS BY THE RAILROAD RETIREMENT BOARD* or Form RRB–1042S, *STATEMENTFOR NONRESIDENT ALIENS OF: PAYMENTS BY THE RAILROAD RETIREMENT BOARD.*

See the instructions for line 20b of Form 1040 or line 13b of Form 1040A to help you figure what part, if any, of your SSEB is taxable. Report the taxable SSEB on line 20b of Form 1040 or line 13b of Form 1040A.

Beginning in 1997, you can choose to have federal income tax withheld from your SSEB part of tier 1 railroad retirement benefits and social security benefits. For more information on your SSEB part of tier 1 benefits, see your Form RRB–1099 instructions and Publication 915, *Social Security and Equivalent Railroad Retirement Benefits.*

The **second category** contains the rest of the tier 1 railroad retirement benefits, called the ''Non-Social Security Equivalent Benefit '' (NSSEB). It also contains any tier 2 benefits, vested dual benefits, and supplemental annuity benefits. Treat this category of benefits, shown on Form RRB–1099–R, *ANNUITIES OR PENSIONS BY THE RAILROAD RETIREMENT BOARD,* as an amount received from a qualified employer plan. This allows for the tax-free recovery of employee contributions from the tier 2 benefits and the NSSEB part of the tier 1 benefits. Vested dual benefits and supplemental annuity benefits are fully taxable.See *Taxation of Periodic Payments,* later, for information on how to report your benefits and how to recover the employee contributions tax free.

Form RRB–1099–R. The following discussion explains the items shown on Form RRB–1099–R. See the illustrated copy of Form RRB–1099–R on the next page.

Box 1—Claim No. and Payee Code. Your claim number is a six- or nine-digit number preceded by an alphabetical prefix. This is the number under which the U.S. Railroad Retirement Board (RRB) paid your benefits. Your payee code follows your claim number and is the last number in this box. It is used by the RRB to identify you under your claim number.

Box 2—Recipient's Identification Number. This is your social security number on record at the RRB.

Box 3—Employee Contributions. The employee contributions are the taxes that were withheld from the railroad employee's pay that **exceeded** the amount of taxes that would have been withheld had the earnings been covered under the social security system. The amount shown in this box is **not** a payment or income that you received in 1996. It is the **latest** amount reported for 1996 and this amount may have increased or decreased from a previous Form RRB–1099–R tax statement due to adjustments in the employee contribution amount. A change in employee contributions may affect the nontaxable part of your NSSEB/tier 2 payment and you may need to recompute that nontaxable amount.

The employee contributions is the employee's cost in the plan (contract). Part of these employee contributions may have been recovered in earlier years. If you or any member of your family had previous railroad retirement annuity entitlement that terminated between January 1, 1975 and December 31, 1983, you should contact the RRB, since the employee contribution amount may not be correct in those cases.

PAYERS' NAME, STREET ADDRESS, CITY, STATE, AND ZIP CODE **UNITED STATES RAILROAD RETIREMENT BOARD** 844 N RUSH ST CHICAGO IL 60611-2092	**1996**		**ANNUITIES OR PENSIONS BY THE RAILROAD RETIREMENT BOARD**
PAYER'S FEDERAL IDENTIFYING NO. 36-3314600	3. Employee Contributions		
1. Claim No. and Payee Code	4. Contributory Amount Paid		COPY B -
2. Recipient's Identification Number	5. Vested Dual Benefit		
Recipient's Name, Street Address, City, State, and Zip Code	6. Supplemental Annuity		REPORT THIS INCOME ON YOUR FEDERAL TAX RETURN. IF THIS FORM SHOWS FEDERAL INCOME TAX WITHHELD IN BOX 9 ATTACH THIS COPY TO YOUR RETURN.
	7. Total Gross Paid		
	8. Repayments		
	9. Federal Income Tax Withheld		THIS INFORMATION IS BEING FURNISHED TO THE INTERNAL REVENUE SERVICE
	10. Rate of Tax	11. Country	

FORM RRB-1099-R

However, if Box 3 is blank, it means that you have recovered all of your employee contributions as of December 31, 1991, or you are the employee's spouse or divorced spouse. In addition, if box 3 is blank, the NSSEB and tier 2 amounts in Box 4 (Contributory Amount Paid) are fully taxable.

Box 4—Contributory Amount Paid. This is the gross amount of NSSEB and tier 2 benefits paid in 1996 minus any repayments of these benefits for 1996. If the RRB was not sure whether a repayment was for 1996 or if the repayment was known to be for a year before 1996, the repayment was not subtracted from the gross amount to figure this amount. That repayment is in Box 8.

Box 5—Vested Dual Benefit. This is the gross amount of vested dual benefit (VDB) payments made in 1996 minus any repayments of these benefits for 1996. It is fully taxable. If the RRB was not sure whether a repayment was for 1996 or if the repayment was known to be for a year before 1996, the repayment was not subtracted from the gross amount to figure this amount. That repayment is in Box 8.

Box 6—Supplemental Annuity. This is the gross amount of supplemental annuity payments made in 1996 minus any repayments of these benefits for 1996. It is fully taxable. If the RRB was not sure whether a repayment was for 1996 or if the repayment was known to be for a year before 1996, the repayment was not subtracted from the gross amount to figure this amount. That repayment is in Box 8.

Box 7—Total Gross Paid. This is the sum of boxes 4, 5, and 6. Write this amount on line 16a of your Form 1040, line 11a of your Form 1040A, or line 17a of your Form 1040NR.

Box 8—Repayments. This amount is the sum of the NSSEB, tier 2, VDB and supplemental annuity repayments for years before 1996 plus the repayments that the RRB has not identified as a current year repayment made to the RRB in 1996. This amount has not been deducted from the amounts shown in Boxes 4, 5, and 6. If you need to know the year(s) to which the repayments apply(ies), and cannot determine that yourself, contact the RRB. The way you will handle these repayments will depend on the year(s) to which the repayments apply(ies), and whether you had included the benefits that you repaid in your gross income for those years. Also, see *Repayment of benefits,* later.

Box 9—Federal Income Tax Withheld. This is the total federal income tax withheld from your NSSEB, tier 2, VDB, and supplemental annuity payments. Include this on your income tax return as tax withheld. If you are taxed as a U.S. citizen, this box includes withholding up to the amount of NSSEB, tier 2, VDB, and supplemental annuity payments you received. If you requested a withholding amount greater than your total monthly NSSEB, tier 2, VDB, and supplemental annuity amount, the additional withholding will be shown in Box 10 of Form RRB–1099.

Box 10—Rate of Tax. If you are taxed as a U.S. citizen or legal resident, this box does ***not*** apply to you. If you are a nonresident alien, an entry in this box indicates the rate at which tax was withheld on the NSSEB, tier 2, VDB, and supplemental annuity payments that were paid to you in 1996. If you are a nonresident alien whose tax was withheld at more than one rate during 1996, you will receive a separate Form RRB–1099–R for each rate change during 1996.

Box 11—Country. If you are taxed as a U.S. citizen or legal resident, this box does ***not*** apply to you. If you are a nonresident alien, an entry in this box indicates the country of which you are a legal resident for tax purposes at the time you received railroad retirement payments in 1996. If you are a nonresident alien who maintained legal residence in more than one country during 1996, you will receive a separate Form RRB–1099–R for each country of legal residence during 1996.

The amounts shown on Form RRB–1099–R do not reflect any special rules, such as the death benefit exclusion, capital gain treatment or the special 5- or 10-year tax option for lump-sum payments, or tax-free rollovers. To determine if any of these rules might apply to your benefits, see the discussions about them later.

Repayment of benefits. If you had to repay any benefits that you had included in your income in an earlier year because at that time you thought you had an unrestricted right to them, you can deduct the amount you repaid in the year in which you repaid it.

Repayment of $3,000 or less. If you repaid $3,000 or less, deduct it in the year you repaid it on line 22 of Schedule A (Form 1040). The 2%-of-adjusted-gross-income limit applies to this deduction. You cannot take this deduction if you file Form 1040A. You must file Form 1040.

Repayment over $3,000. If you repaid more than $3,000, you can deduct the amount repaid or you can take a credit against your tax. Follow the steps below and compare the results. Use the method (deduction or credit) that results in less tax.

1) Figure your tax for 1996 claiming a deduction for the repayment on line 22 of Schedule A (Form 1040).
2) Figure your tax for 1996 without deducting the repayment. Then,
   a) Refigure your tax for the earlier year without including the repayment in income.
   b) Subtract the tax in (a) from the tax shown on your return for the earlier year.
   c) Subtract the answer in (b) from your tax for 1996 figured without the deduction.

If the answer in step (1) is less than the answer in step (2)(c), deduct the repayment on line 27 of Schedule A (Form 1040). This deduction is not subject to the 2%-of-adjusted-gross-income limit.

If the answer in step (2)(c) is less than the answer in step (1), take a credit against your tax. Enter the amount of your answer in step (2)(b) on line 57, Form 1040, and write ''I.R.C. 1341''next to line 57.

Withholding Tax and Estimated Tax

Your retirement plan payments are subject to federal income tax withholding. However, you can choose not to have tax withheld on payments you receive unless they are eligible rollover distributions. If you choose not to have tax withheld, you may have to make estimated tax payments. Also, if you do not have enough tax withheld, you may have to make estimated tax payments. See *Estimated tax,*later.

The withholding rules apply to the ***taxable*** part of payments you receive from an employer pension, annuity, profit-sharing, stock bonus, or other deferred compensation plan. The rules also apply to payments from an individual retirement arrangement and payments from a commercial annuity. For this purpose, a commercial annuity means an annuity, endowment, or life insurance contract issued by an insurance company. There will be no withholding on any part of a distribution that it is reasonable to believe will not be includible in gross income.

These withholding rules also apply to disability pension distributions received before your minimum retirement age. See *Disability Retirement,* later.

Choosing no withholding. You can choose not to have tax withheld from your retirement plan payments unless they are eligible rollover distributions. The payer will tell you how to make the choice. This choice remains in effect until you revoke it.

The payer will ignore your choice not to have tax withheld if:

1) You do not give the payer your social security number (in the required manner), or
2) The IRS notifies the payer, before the payment is made, that you gave an incorrect social security number.

To choose not to have tax withheld, a U.S. citizen or resident must give the payer a home address in the United States or its possessions. Without that address, the payer must withhold tax. For example, the payer has to withhold tax if the recipient has provided a U.S. address for a nominee, trustee, or agent to whom the benefits are delivered, but has not provided his or her own U.S. home address.

If you do not give the payer a home address in the United States or its possessions, you can choose not to have tax withheld only if you certify to the payer that you are not a U.S. citizen, a U.S. resident alien, or someone who left the country to avoid tax. But if you so certify, you may be subject to the 30% flat rate withholding that applies to nonresident aliens. This 30% rate will not apply if you are exempt or subject to a reduced rate by treaty. For details, get Publication 519, *U.S. Tax Guide for Aliens.*

Periodic payments. Unless you choose no withholding, your annuity or periodic payments (other than eligible rollover distributions) will be treated like wages for withholding purposes. Periodic payments are amounts paid at regular intervals (such as weekly, monthly, or yearly), for a period of time greater than one year (such as for 15 years or for life). You should give the payer a completed withholding certificate (Form W–4P or a similar form provided by the payer). If you do not, the payer must withhold as if you were married with three withholding allowances. However, the payer must withhold as if you were single with no withholding allowances if:

1) You do not give the payer your social security number (in the required manner), or
2) The IRS notifies the payer, before the payment is made, that you gave an incorrect social security number.

You must file a new withholding certificate to change the amount of withholding.

Nonperiodic distributions. For a nonperiodic distribution (a payment other than a periodic payment) that is not an eligible rollover distribution, the withholding is 10% of the distribution, unless you choose not to have tax withheld. You can use Form W-4P to elect to have no income tax withheld. You may also request the payer to withhold an additional amount using Form W-4P. The part of any loan treated as a distribution (except an offset amount to repay the loan), explained later, is subject to withholding under this rule.

Eligible rollover distributions. An eligible rollover distribution is any distribution of all or any part of the balance to your credit in a qualified retirement plan except:

- The nontaxable part of a distribution,
- A required minimum distribution (described under *Tax on Excess Accumulation,* later), or
- Any of a series of substantially equal distributions paid at least once a year over your lifetime or life expectancy (or the lifetimes or life expectancies of you and your beneficiary), or over a period of 10 years or more.

See *Rollovers,* later for additional exceptions.

Withholding. If you receive an eligible rollover distribution, 20% of it generally will be withheld for income tax. You cannot choose to have no withholding. But, tax will not be withheld from the eligible rollover distribution if you have the plan administrator pay it directly to another qualified plan or an IRA in a direct rollover. See *Rollovers,* later, for more information.

Estimated tax. Your estimated tax is the total of your expected income tax, self-employment tax, and certain other taxes for the year, minus your expected credits and withheld tax. Generally, you must make estimated tax payments if your estimated tax as defined above is $500 or more and you estimate that the total amount of income tax to be withheld will be less than the lesser of 90% of the tax to be shown on your return, or 100% of the tax shown on last year's return. Substitute 110% for 100% if your adjusted gross income (AGI) for the preceding tax year was more than $150,000 ($75,000 if married filing separately). For more information, get Publication 505, *Tax Withholding and Estimated Tax.*

TIP *In figuring your withholding or estimated tax, remember that a part of your monthly* ***social security or equivalent tier 1 railroad retirement benefits*** may be taxable. The amount subject to tax will depend on the type of benefit received. See *Railroad Retirement,* earlier, and Publication 915, Social Security and Equivalent Railroad Retirement Benefits.

Taxation of Periodic Payments

This section explains how the periodic payments you receive under a pension or annuity plan are taxed. Periodic payments are amounts paid at regular intervals (such as weekly, monthly, or yearly) for a period of time greater than one year (such as for 15 years or for life). These payments are also known as ***amounts received as an annuity.*** If you receive an amount from your plan that is ***not*** a periodic payment, see *Taxation of Nonperiodic Payments,* later.

In general, you can recover your cost of the pension or annuity tax free over the period you are to receive the payments. The amount of each payment that is more than the part that represents your cost is taxable. The various rules for determining the part of each annuity payment that represents your cost are described in the following discussion.

Investment in the Contract (Cost)

The first step in figuring how much of your pension or annuity is taxable is to determine your cost (investment in the contract). Then, if you use the Simplified General Rule, you simply divide your cost by the appropriate factor from the worksheet (see *Simplified General Rule,* later). This gives you the tax-free amount of each monthly annuity payment. If your annuity starting date is after 1986, your total exclusion from income over the years cannot exceed your cost. Your cost is also very important in figuring your exclusion under the nonsimplified General Rule, but that rule is not covered in this publication. For information on it, get Publication 939.

Cost. In general, your cost is your net investment in the contract as of the annuity starting date (defined next). To find this amount, you must first figure the total premiums, contributions, or other amounts you paid. This includes the amounts your employer contributed that were taxable when paid. (Also see *Foreign employment,* later.) It does not include amounts you contributed for health and accident benefits (including any additional premiums paid for double indemnity or disability benefits) or deductible voluntary employee contributions.

From this total cost you must subtract:

1) Any refunded premiums, rebates, dividends, or unrepaid loans that were not included in your income and that you received by the later of the annuity starting date or the date on which you received your first payment.
2) Any other tax-free amounts you received under the contract or plan by the later of the dates in (1).

Generally, the amount of your contributions recovered tax free during the year is shown in box 5 of Form 1099–R. However, if periodic payments began before 1993, the payer does not have to complete box 5 (but may choose to do so). In addition, if you began receiving periodic payments of a life annuity in 1996 that are eligible for reporting under the Simplified General Rule (explained later), the payer must show your total contributions to the plan in box 9b of your 1996 Form 1099–R.

Annuity starting date. The annuity starting date is either the first day of the first period for which you receive payment under the contract or the date on which the obligation under the contract becomes fixed, whichever comes later.

Example. On January 1 you completed all your payments required under an annuity contract providing for monthly payments starting on August 1 for the period beginning July 1. The annuity starting date is July 1. This is the date you use in figuring your cost of the contract and selecting the appropriate factor from the table in the Simplified General Rule worksheet.

Foreign employment. If you worked abroad before 1963 and were entitled to exclude your earned income from sources outside the United States, your contributions include amounts contributed before 1963 by your employer for that work. Your contributions also include amounts contributed after 1962 by your employer for that work if you performed the services under a plan that existed on March 12, 1962.

Death benefit exclusion. If you are the ***beneficiary*** of a deceased employee or a deceased former employee, who died before August 21, 1996, benefits you get from an employer's retirement plan because of that person's death may qualify for a death benefit exclusion. This exclusion cannot be more than $5,000. The maximum total exclusion is $5,000 for each employee regardless of the number of employers paying death benefits or the number of beneficiaries.

CAUTION *If you are the beneficiary of an employee who died after August 20, 1996, you are not eligible for the $5,000 death benefit exclusion.*

Treat the amount of any allowable death benefit exclusion as additional contributions to the plan by the employee. Add it to the cost or unrecovered cost of the annuity at the annuity starting date.

The death benefit exclusion applies to distributions from both qualified and nonqualified retirement plans to the beneficiaries or the estate of a common-law employee. The exclusion also applies to distributions from qualified retirement plans to the beneficiaries or the estate of a self-employed individual, including a partner. A shareholder-employee who owns more than 2% of the stock of an S corporation (or more than 2% of the combined voting power of all stock) is treated as a self-employed individual.

Generally, the death benefit exclusion does not apply to amounts that the employee had, immediately before death, a nonforfeitable right to receive while living. However, it does apply if the nonforfeitable right is to a lump-sum distribution from a qualified pension, annuity, stock bonus, or profit-sharing plan or from certain tax-sheltered annuities.

If you are the survivor under a ***joint and survivor annuity,*** the exclusion applies only if:

1) The decedent had received no retirement pension or annuity payments, or
2) The decedent had received only disability income payments that were not treated as pension or annuity income (the decedent had not reached minimum retirement age).

If the employee died after the annuity starting date, the death benefit exclusion applies only to amounts received by beneficiaries other than the survivor under a joint and survivor annuity.

Generally, if your benefits qualify for the death benefit exclusion, box 7 of your Form 1099–R will contain the code "B".

Example. Herb Rider's employer had a pension plan that provided that Herb would receive annuity payments after he retired and his wife, Barbara, would receive a survivor annuity after his death. The plan also provided that any of his children under age 22 at the time of his death would receive annuity payments until the child married, ceased to be a student, reached age 22, or died. No reduction is made in Herb's or Barbara's annuity for these payments to their children. After Herb retired, he started receiving annuity payments. He died 3 months later on August 15, 1996. At that time he had one child who was under 22 years old.

Barbara cannot claim the death benefit exclusion because she is the surviving annuitant under a joint and survivor annuity and Herb died after the annuity starting date.

Herb's child can claim the death benefit exclusion. The amounts paid to the child are not paid under a joint and survivor annuity, but are paid by or for his employer and are paid because of his death.

Allocation of the exclusion. If the total amount of death benefits from all employers is more than $5,000 and the payments are made to more than one beneficiary, then part of the $5,000 exclusion must be allocated to each beneficiary. You figure your share of the exclusion by multiplying the $5,000 by a fraction that has as its numerator the amount of the death benefit that you received and as its denominator the total death benefits paid to all beneficiaries.

Example. John was an employee of the XYZ Corporation at the time of his death. XYZ pays a $20,000 death benefit to John's beneficiaries as follows:

- $10,000 to Ann, his widow,
- $6,000 to Betty, his daughter, and
- $4,000 to Chris, his son.

No other death benefits are paid by any other employer. Ann will exclude $2,500 ($5,000 × $10,000/$20,000), Betty will exclude $1,500 ($5,000 × $6,000/$20,000), and Chris will exclude $1,000 ($5,000 × $4,000/$20,000).

Fully Taxable Payments

The pension or annuity payments that you receive are fully taxable if you have no investment in the contract (cost) because:

1) You did not pay anything or are not considered to have paid anything for your pension or annuity,
2) Your employer did not withhold contributions from your salary, or
3) You got back all of your contributions tax free in prior years (however, see *Exclusion not limited to cost* under *Partly Taxable Payments,* later).

Report the total amount you got on line 16b, Form 1040, or line 11b, Form 1040A. You should make no entry on line 16a, Form 1040, or line 11a, Form 1040A.

Deductible voluntary employee contributions. Distributions you receive that are based on your accumulated deductible voluntary employee contributions are generally fully taxable in the year distributed to you. Accumulated deductible voluntary employee contributions include net earnings on the contributions. If distributed as part of a lump sum, they do not qualify for the 5– or 10–year tax option or capital gain treatment.

Partly Taxable Payments

If you contributed to your pension or annuity and your annuity starting date is after July 1, 1986, you must use either the General Rule or, if you qualify, the Simplified General Rule to figure the taxability of your payments. If your annuity starting date was before July 2, 1986, and you did not recover your cost using the Three-Year Rule, you must use the General Rule. (If you recovered your cost under the Three-Year Rule, you cannot use the General Rule or the Simplified General Rule because your payments are fully taxable.)

Under either the General Rule or the Simplified General Rule, you exclude a part of each payment from your income because it is considered a return of your annuity cost.

Exclusion limited to cost. If your annuity starting date is after 1986, the total amount of annuity income that you can exclude over the years as a return of the cost cannot exceed your total cost. (Reduce your cost by the value of any refund to be received if you are using the General Rule.) Any unrecovered cost at your (or the last annuitant's) death is allowed as a miscellaneous itemized deduction on the final return of the decedent. This deduction is not subject to the 2%-of-adjusted-gross-income limit.

Example 1. Your annuity starting date is after 1986, and you exclude $100 a month under the Simplified General Rule. Your total cost of the annuity is $12,000. Your exclusion ends when you have recovered your cost tax free, that is, after 10 years (120 months). Thereafter, your annuity payments are fully taxable.

Example 2. The facts are the same as in Example 1, except you die (with no surviving annuitant) after the eighth year of retirement. You have recovered tax free only $9,600 (8 × $1,200) of your investment. An itemized deduction for your unrecovered investment of $2,400 ($12,000 minus $9,600) can be taken on your final return.

Exclusion not limited to cost. If your annuity starting date was before 1987, you could continue to take your monthly exclusion for as long as you receive your annuity. Follow this procedure whether you figured the exclusion under the General Rule or the Simplified General Rule. If you choose a joint and survivor annuity, your survivor continues to take the survivor's exclusion figured as of the annuity starting date. The total exclusion may be more than your investment (cost) in the contract. If your annuity starting date was after July 1, 1986, and the last annuitant dies before the total cost is recovered, the unrecovered cost is allowed as a miscellaneous itemized deduction on the final return of the decedent. The deduction is not subject to the 2%-of-adjusted-gross-income limit.

General Rule. Under the General Rule, you determine the tax-free part of each annuity payment based on the ratio of your cost of the contract to the total expected return. Expected return is the total amount you and other eligible annuitants can expect to receive under the contract. To figure it, you must use life expectancy (actuarial) tables prescribed by the IRS. Under the new law, nonqualified plans will continue to use the General Rule.

The General Rule is not discussed further in this publication. Complete information on the General Rule, including the tables you need, is contained in Publication 939, *Pension General Rule (Nonsimplified Method).*

CAUTION *For annuity starting dates beginning after November 18, 1996, you generally cannot use the General Rule for annuity payments from a qualified plan.*

Simplified General Rule

If you can use the Simplified General Rule to figure the taxability of your annuity, it will probably be simpler and more beneficial than the General Rule.

Who can use it. You may be able to use the Simplified General Rule if you are a retired employee or are the survivor, receiving a survivor annuity, of an employee who died. If you are a survivor of a deceased retiree, you can use the Simplified General Rule if the retiree used it. You can use this simpler method to figure the taxability of your annuity ***only*** if:

1) Your annuity starting date is after July 1, 1986,

2) The annuity payments are for either your life, or your life and that of your beneficiary,

3) The annuity payments are from a qualified employee plan, a qualified employee annuity, or a tax-sheltered annuity, ***and***

4) At the time the payments began, you were either under age 75 ***or*** entitled to fewer than 5 years of guaranteed payments.

If you are 75 or over, you must use the General Rule unless the payments are guaranteed for less than 5 years.

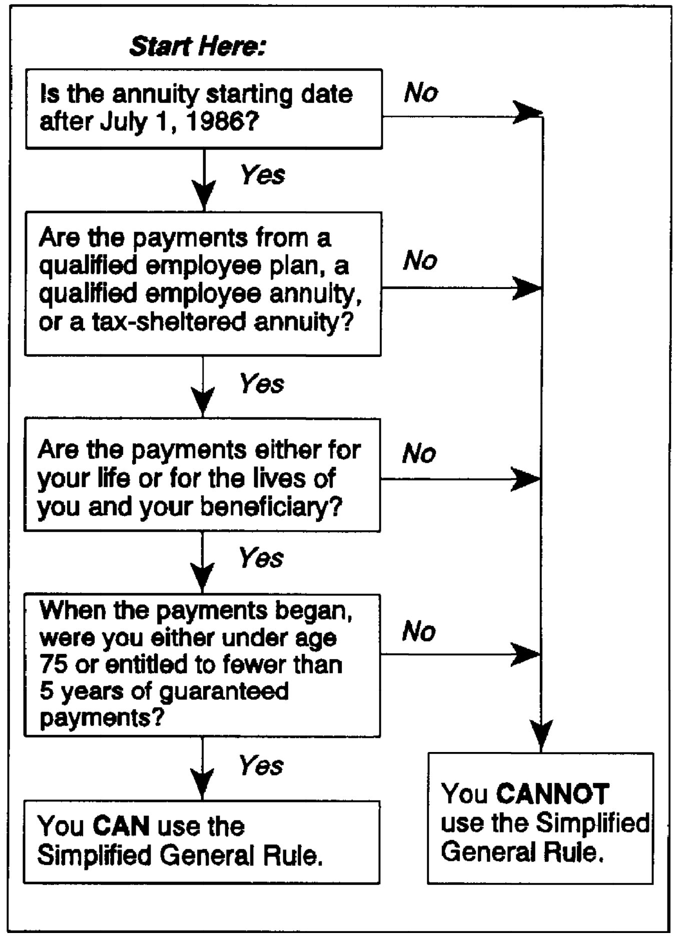
Your annuity contract provides **guaranteed payments** if a minimum number of payments or a minimum amount (for example, the amount of your investment) is payable even if you and any survivor annuitant do not live to receive the minimum. If the minimum amount is less than the total amount of the payments you are to receive, barring death, during the first 5 years after payments begin (figured by ignoring any payment increases), you are entitled to fewer than 5 years of guaranteed payments for purposes of (4) above.

CAUTION *If your annuity starting date is after November 18, 1996, you generally cannot use the General Rule for annuity payments from a qualified plan. You must use the Simplified General Rule. Nonqualified plans (and certain annuitants age 75 or over) must use the General Rule.*

If your annuity starting date is after July 1, 1986 (and before November 19, 1996), but your annuity does not meet all of the other conditions listed above, you must use the nonsimplified General Rule. For example, if your annuity payments are from a contract you bought directly, you must use the nonsimplified General Rule. You also must use the nonsimplified General Rule if your annuity payments are from a nonqualified employee retirement plan.

Figure A. **Can You Use the Simplified General Rule?**

CAUTION. *If your annuity starting date is after November 18, 1996, STOP.* The rules in *Figure A* do not apply to you.



How to use it. If you meet these conditions and you choose the Simplified General Rule, use the worksheet in the back of the publication to figure your taxable annuity for 1996. In completing this worksheet, use your age at the birthday preceding your annuity starting date. Be sure to keep the completed worksheet; it will help you figure your 1997 taxable annuity.

Example. Bill Kirkland, age 65, began receiving retirement benefits in January 1996 under a joint and survivor annuity. The benefits are to be paid for the joint lives of Bill and his wife, Kathy. He had contributed $24,000 to the plan and had received no distributions before the annuity starting date. Bill is to receive a retirement benefit of $1,000 a month, and Kathy is to receive a monthly survivor benefit of $500 upon Bill's death.

Bill chooses to use the Simplified General Rule computation. Since his annuity starting date is before November 19, 1996, the new law does not apply to him. He fills in Worksheet A (for annuities starting before November 19, 1996), as follows:

Worksheet A—Simplified General Rule

1.	Total pension received this year. Also, add this amount to the total for Form 1040, line 16a, or Form 1040A, line 11a		$12,000
2.	Your cost in the plan (contract) at annuity starting date ***(before November 19, 1996)***, plus any death benefit exclusion (if it applies. See *Caution* below)		24,000
3.	Age at annuity starting date:	Enter:	
	55 and under	300	
	56–60	260	
	61–65	240	
	66–70	170	
	71 and over	120	240
4.	Divide line 2 by line 3		100
5.	Multiply line 4 by the number of months for which this year's payments were made		1,200
	NOTE: If your annuity starting date is **before 1987,** enter the amount from line 5 on line 8 below. Skip lines 6, 7, 10, and 11.		
6.	Any amounts previously recovered tax free in years after 1986		–0–
7.	Subtract line 6 from line 2		24,000
8.	Enter the lesser of line 5 or line 7		1,200
9.	**Taxable pension for year.** Subtract line 8 from line 1. Enter the result, but not less than zero. Also add this amount to the total for Form 1040, line 16b, or Form 1040A, line 11b		$10,800
	NOTE: If your Form 1099–R shows a larger taxable amount, use the amount on line 9 instead.		
10.	Add lines 6 and 8		1,200
11.	Balance of cost to be recovered. Subtract line 10 from line 2		$22,800

Bill's tax-free monthly amount is $100 (see line 4 of the worksheet). If he lives to collect more than 240 payments, he will have to include the full amount of the additional payments in his gross income.

If Bill dies before collecting 240 monthly payments and Kathy begins receiving payments, she will also exclude $100 from each payment until her payments, when added to Bill's, total 240 payments. If she dies before 240 payments are made, a miscellaneous itemized deduction will be allowed for the unrecovered cost on her final income tax return. This deduction is not subject to the 2%-of-adjusted-gross-income limit.

CAUTION *If you are the beneficiary of an employee who died after August 20, 1996, you are not eligible for the $5,000 death benefit exclusion.*

Death benefit exclusion. If you are a beneficiary of a deceased employee or former employee, who died before August 21, 1996, you may qualify for a death benefit exclusion of up to $5,000. This exclusion is discussed under *Investment in the Contract (Cost),* earlier. If you choose to use the Simplified General Rule and you qualify for the death benefit exclusion, increase the total investment in the pension or annuity contract by the allowable death benefit exclusion. Total investment is on line 2 of the worksheet.

The payer of the annuity cannot add the death benefit exclusion to the cost for figuring the taxable part of payments reported on Form 1099–R. Therefore, the Form 1099–R taxable amount will be larger than the amount you will figure for yourself. Report on Form 1040, line 16b, or Form 1040A, line 11b, the smaller amount that you figure. Keep a copy of the completed worksheet for your records until you fully recover the cost of the annuity.

Example. Diane Greene, age 48, began receiving a $1,500 monthly annuity in March of 1996 upon the death of her husband. She received 10 payments in 1996. Her husband had contributed $25,000 to his qualified retirement plan. In addition, Diane is entitled to a $5,000 death benefit exclusion for the annuity payments because her husband died before August 21, 1996. She adds that amount to her husband's contributions to the plan, for a total cost in the contract of $30,000.

Diane chooses to use the Simplified General Rule. She fills in Worksheet A (for annuities starting before November 19, 1996), as follows:

Worksheet A—Simplified General Rule

1.	Total pension received this year. Also, add this amount to the total for Form 1040, line 16a, or Form 1040A, line 11a		$15,000
2.	Your cost in the plan (contract) at annuity starting date **(before November 19, 1996)**, plus death benefit exclusion (if it applies. See *Caution,* earlier)		30,000
3.	Age at annuity starting date:	Enter:	
	55 and under	300	
	56–60	260	
	61–65	240	
	66–70	170	
	71 and over	120	300
4.	Divide line 2 by line 3		100
5.	Multiply line 4 by the number of months for which this year's payments were made		1,000
	NOTE: If your annuity starting date is **before 1987,** enter the amount from line 5 on line 8 below. Skip lines 6, 7, 10, and 11.		
6.	Any amounts previously recovered tax free in years after 1986		–0–
7.	Subtract line 6 from line 2		30,000
8.	Enter the lesser of line 5 or line 7		1,000

9.	**Taxable pension for year.** Subtract line 8 from line 1. Enter the result, but not less than zero. Also add this amount to the total for Form 1040, line 16b, or Form 1040A, line 11b	$14,000
	NOTE: If your Form 1099–R shows a larger taxable amount, use the amount on line 9 instead.	
10.	Add lines 6 and 8	1,000
11.	Balance of cost to be recovered. Subtract line 10 from line 2	$29,000

In completing Form 1099–R, the payer of the annuity chooses to report the taxable part of the annuity payments using the Simplified General Rule. However, since the payer does not adjust the investment in the contract by the death benefit exclusion, the payer figures the tax-free part of each monthly payment to be $83.33, as follows:

$$\frac{\text{Total cost:}\quad \$25{,}000}{\text{Expected payments:}\quad 300} = \$83.33 \text{ (Monthly return of cost)}$$

However, Diane figures a $100 monthly tax-free amount (see line 4 of the worksheet). Because of this difference in the computations, the Form 1099–R Diane receives from the payer shows a greater taxable amount than what she figures for herself. She reports on line 16b of Form 1040 only the smaller taxable amount based on her own computation.

Changing the method. If your annuity starting date is after July 1, 1986 (but before November 19, 1996), you can change the way you figure your pension cost recovery exclusion. You can change from the General Rule to the Simplified General Rule, or the other way around. Make the change by filing amended returns for all your tax years beginning with the year in which your annuity starting date occurred. You must use the same method for all years. Generally, you can make the change only within 3 years from the due date of your return for the year in which you received your first annuity payment. You can make the change later if the date of the change is within 2 years after you paid the tax for that year.

CAUTION *If your annuity starting date is after November 18, 1996, you generally must use the Simplified General Rule. Nonqualified plans (and certain annuitants age 75 or over) must continue to use the General Rule.*

Disability Retirement

If you retired on disability, you must report your disability income as ordinary income. However, you may be entitled to a credit. See *Credit for Elderly or Disabled,* later.

Disability Payments

If you retired on disability, payments you receive are taxable as wages until you reach ***minimum retirement age.*** Beginning on the day after you reach minimum retirement age, your payments are treated as a pension or annuity. At that time you begin to recover your cost of the annuity under the rules discussed earlier.

Minimum retirement age. Minimum retirement age is the age at which you could first receive an annuity were you not disabled.

How to report. You must report all your taxable disability payments on line 7, Form 1040 or Form 1040A, until you reach minimum retirement age.

Credit for Elderly or Disabled

You may be able to take the credit for the elderly or the disabled if:

1) You were age 65 or older at the end of the tax year, or
2) You were under age 65 at the end of the tax year and you meet all of the following tests:
   a) You are retired on permanent and total disability, or if you retired before 1977, you were permanently and totally disabled on January 1, 1976, or January 1, 1977,
   b) You received taxable disability income, and
   c) You did not reach ***mandatory retirement age*** before the beginning of the tax year.

You are retired on permanent and total disability if you were permanently and totally disabled when you retired and are still permanently and totally disabled. Also, you must receive disability income because of the disability. If you retired on disability before 1977, you did not have to be permanently and totally disabled at the time you retired. However, you must have been permanently and totally disabled on January 1, 1976, or January 1, 1977.

Mandatory retirement age. Mandatory retirement age is the age set by your employer at which you must retire.

Permanently and totally disabled. You are permanently and totally disabled if you cannot engage in ***any*** substantial gainful activity because of your physical or mental condition. The substantial gainful activity is not limited to your job activity performed before you retired, or a similar activity. For more information on what is substantial gainful activity, get Publication 524, *Credit for the Elderly or the Disabled.*

Physician's statement. A doctor must determine that your condition is expected to result in death or has lasted, or can be expected to last, for a continuous period of at least 12 months. Have your doctor complete the *Physician's Statement* in Part II of either Schedule R

(Form 1040) or Schedule 3 (Form 1040A). The statement usually must be completed each year you claim the credit. However, it does not have to be completed if:

1) You filed a physician's statement for the same disability with your return for 1983 or an earlier year, or
2) You filed a statement for tax years after 1983 and your doctor signed line B on the statement.

If either exception applies, check the box on line 2 in Part II.

Figuring the credit. The IRS can figure the credit for you. See the instructions for Form 1040 or Form 1040A.

For complete information on this credit, get Publication 524.

Taxation of Nonperiodic Payments

This section of the publication explains how any ***nonperiodic*** payments you receive under a pension or annuity plan are taxed. Nonperiodic payments are also known as ***amounts not received as an annuity.*** They include all payments other than periodic payments. How much of these payments is subject to tax depends on when they are made in relation to the annuity starting date. If they are made ***before*** the annuity starting date, their tax treatment depends on the type of contract or transaction from which they result.

Distributions of current earnings (dividends) on your investment in an annuity, endowment, or life insurance contract are generally taxable as amounts not received as an annuity. However, do not include these distributions in your income to the extent the insurer uses them to pay premiums or some other consideration for the contract.

Once you figure how much of a nonperiodic distribution is subject to tax, you generally can use the rules for tax-free rollovers or you can use the rules for the 5- or 10-year tax option or capital gain treatment of amounts that qualify as lump-sum distributions. These rules are discussed later. If these rules do not apply, report the total amount of the distribution on line 16a, Form 1040, or line 11a, Form 1040A. Report the taxable amount on line 16b, Form 1040, or line 11b, Form 1040A.

Nonperiodic distribution on or after annuity starting date. If you receive a nonperiodic payment from your annuity contract ***on or after the annuity starting date,*** you generally must include all of the payment in gross income. For example, a cost-of-living increase in your pension after the annuity starting date is an amount not received as an annuity and, as such, is fully taxable.

Reduction in subsequent payments. If the annuity payments you receive are reduced because you received the nonperiodic distribution, you can exclude part of the nonperiodic distribution from gross income. The part you can exclude is equal to your cost in the contract reduced by any tax-free amounts you previously received under the contract, multiplied by a fraction. The numerator (top part of the fraction) is the reduction in each annuity payment because of the nonperiodic distribution. The denominator (bottom part of the fraction) is the full unreduced amount of each annuity payment originally provided for.

Distribution in full discharge of contract. You may receive an amount on or after the annuity starting date that fully satisfies the payer's obligation under the contract. The amount may be a refund of what you paid for the contract or for the complete surrender, redemption, or maturity of the contract. Include the amount in gross income only to the extent that it exceeds your remaining cost of the contract.

Distribution before annuity starting date. If you receive a nonperiodic distribution ***before*** the annuity starting date from a ***qualified retirement plan,*** you generally can allocate only part of it to your cost of the contract. You exclude from your gross income the part that you allocate to your cost of the contract. You include the remainder in your gross income. (But see *Exceptions,* later.)

For this purpose, a qualified retirement plan includes a:

1) Qualified employee retirement plan (or annuity contract purchased by such a plan),
2) Qualified annuity plan,
3) Tax-sheltered annuity, and
4) Individual retirement arrangement (IRA).

To figure the excludable amount of a distribution before the annuity starting date from such a qualified retirement plan, use the following formula:

$$\text{Amount received} \times \frac{\text{Cost of contract}}{\text{Account balance}} = \text{Excludable amount}$$

For this purpose, your account balance includes only amounts to which you have a nonforfeitable right (a right that cannot be taken away).

Under a defined contribution plan, your contributions (and income allocable to them) may be treated as a separate contract for figuring the taxable part of any distribution. A defined contribution plan is a plan in which you have an individual account. Your benefits are based only on the amount contributed to the account and the income, expenses, etc., allocated to the account.

Example. Before she had a right to an annuity, Ann Blake received $50,000 from her retirement plan. She had $10,000 invested (cost) in the plan, and her account balance was $100,000. She can exclude $5,000 of the $50,000 received, figured as follows:

$$\$50,000 \times \frac{\$10,000}{\$100,000} = \$5,000$$

Plans that permitted withdrawal of employee contributions. If your pension plan, as of May 5, 1986, permitted the withdrawal of any of your employee contributions before your separation from service, the allocation described above applies only to a limited extent. (Employee contributions do not include employer contributions under a salary reduction agreement.) It applies only if the distribution received before the annuity starting date exceeds your cost of the contract as of December 31, 1986. Increase the distribution by amounts previously received under the contract after 1986. Any distribution you receive before the annuity starting date that does not exceed your cost of the contract on December 31, 1986, is a tax-free recovery of cost.

If your plan is a plan maintained by a state government that on May 5, 1986, permitted withdrawal of employee contributions other than as an annuity, the above rule for limited allocation applies to you. This is true even if your pension plan did not permit withdrawal of your contributions before separating from service. Treat any amount received (other than as an annuity) before or with the first annuity payment as an amount received before the annuity starting date.

Distribution from plans other than qualified retirement plans. If you receive a nonperiodic distribution before the annuity starting date from a plan ***other than*** a qualified retirement plan, it is allocated first to earnings (the taxable part) and then to the cost of the contract (the tax-free part). This treatment applies, for example, to a commercial annuity contract you bought directly. You include in your gross income the smaller of:

1) The nonperiodic distribution, or
2) The amount by which:
   a) The cash value of the contract (figured without considering any surrender charge) immediately before you receive the distribution, exceeds
   b) Your investment in the contract at that time.

Example. You bought an annuity from an insurance company. Before the annuity starting date under your annuity contract, you received a $7,000 distribution. At the time of the distribution, the annuity had a cash value of $16,000 and your investment in the contract was $10,000. Because the distribution is allocated first to earnings, you must include $6,000 ($16,000 – $10,000) in your gross income. The remaining $1,000 is a tax-free return of part of your investment.

Exceptions. Certain nonperiodic distributions received before the annuity starting date are ***not*** subject to the allocation rules discussed earlier. If you receive such a distribution, include it in gross income only to the extent that it exceeds your cost of the contract.

This treatment applies to the following:

- **Distributions in full discharge of a contract** that you receive as a refund of what you paid for the contract or for the complete surrender, redemption, or maturity of the contract.
- **Distributions from life insurance or endowment contracts** (other than modified endowment contracts, as defined in Internal Revenue Code section 7702A) that are not received as an annuity under the contracts.
- **Distributions under contracts entered into before August 14, 1982,** to the extent that they are allocable to your investment before August 14, 1982.

For example, if you purchased an annuity contract and made investments both before August 14, 1982, and after August 13, 1982, the distributed amounts are allocated to your investment or to earnings in the following order:

1) The part of your investment (tax free to you) that was made before August 14, 1982.
2) The earnings (taxable to you) on the part of your investment that was made before August 14, 1982.
3) The earnings (taxable to you) on the part of your investment that was made after August 13, 1982.
4) The part of your investment (tax free to you) that was made after August 13, 1982.

Distribution of U.S. Savings Bonds. If you receive U.S. Savings Bonds in a taxable distribution from a retirement plan, report the value of the bonds at the time of distribution as income. The value of the bonds includes accrued interest. When you cash the bonds, your Form 1099–INT will show the total interest accrued, including the part you reported when the bonds were distributed to you. For information on how to adjust your interest income for U.S. Savings Bond interest you previously reported, see *How to Report Interest Income* in Chapter 1 of Publication 550, *Investment Income and Expenses.*

Excess Contributions, Deferrals, and Annual Additions

If the contributions made for you during the year to certain retirement plans exceed certain limits, the excess may be taxable to you. The following discussions explain some of these limits and how you treat the excess amounts on your tax return.

Elective deferrals. If you are covered by certain kinds of retirement plans, you can choose to have part of your pay contributed by your employer to a retirement fund, rather than have it paid to you. These amounts are called ''elective deferrals,'' because you choose (elect) to set aside the money, and you defer the tax on the money until it is distributed to you.

Elective deferrals include elective contributions to cash or deferred arrangements (known as section 401(k) plans), section 501(c)(18) plans, salary reduction simplified employee pension (SARSEP) plans and tax-sheltered annuities. However, an employer contribution to a tax-sheltered annuity is not treated as an elective deferral if it is made under a one-time irrevocable choice by you as soon as you become eligible to participate in the agreement.

CAUTION *After December 31, 1996, an employer is no longer allowed to establish a Salary Reduction Simplified Employee Pension (SARSEP). Transition rules will allow participants to contribute to the current plan.*

Because these contributions (elective deferrals) are considered to be made by your employer, you are taxed on any payments you receive from the retirement fund unless you roll over the payments. See *Rollovers,* later. If a payment from the fund meets the requirements of a lump-sum distribution, it may qualify for the 5– or 10–year tax option. This is also discussed later.

Limits on elective deferrals. For 1996, generally, you may not defer more than a total of $9,500 for all qualified plans by which you are covered. (This limit applies without regard to community property laws.) The amount you can defer each year may be further limited if you are a highly compensated employee. The amount deferred by highly compensated employees as a percentage of pay can be no more than 125% of the average deferral percentage (ADP) of all eligible nonhighly compensated employees. Your employer or plan administrator can probably tell you the amount of the deferral limit under this ADP test and whether it applies to you. If you deferred more than $9,500 (or a lower limit under the ADP test), you must include the excess in your gross income for 1996.

Special limit for tax-sheltered annuities. If you are covered by only one plan and that plan is a tax-sheltered annuity, you may defer up to $9,500 each year. If you are covered by several different plans and at least one of the plans is a tax-sheltered annuity, then the basic limit ($9,500 for 1996) for all deferrals does not increase by the amount deferred in the tax-sheltered annuity that year. This $9,500 limit stays the same even if you are covered by more than one tax-sheltered annuity.

However, if you have completed at least 15 years of service with an educational organization, hospital, home health service agency, health and welfare service agency, church, or convention or association of churches (or associated organization), the $9,500 annual limit increases. This increased limit for any year is $9,500 plus the ***least*** of the following amounts:

1) $3,000,
2) $15,000, reduced by elective deferrals over $9,500 you were allowed in earlier years because of this years-of-service rule, or
3) $5,000 times the number of your years of service for the organization, minus the total elective deferrals under the plan for earlier years.

Cost-of-living adjustment. For 1996, the basic limit on elective deferrals is increased from $9,240 to $9,500. This limit is subject to annual increases to reflect inflation (as measured by the Consumer Price Index).

Reporting by employer. Your employer must report your elective deferrals for the year on your Form W–2, *Wage and Tax Statement.* Your employer should mark the ''Deferred compensation'' checkbox in box 15 and show the total amount deferred in box 13.

Treatment of excess deferrals. If the total you defer is more than the limit for the year, you must include the excess in your gross income for the year. If the plan permits, you can receive the excess amount. Although your employer must report on your Form W-2 the total amount of your elective deferrals, you (not the employer) are responsible to monitor the total you defer to ensure that the deferral limit is not exceeded. As explained below, you must notify the plan if you exceed the limit on excess deferrals.

If you participate in only one plan and it permits these distributions, you must notify the plan by the date required by the plan that the deferral was too large. The plan must then pay you the amount of the excess, along with any income earned on that amount, by April 15 of the following year.

If you participate in more than one plan, you can have the excess paid out of any of the plans that permit these distributions. You must notify each plan by the date required by that plan of the amount to be paid from that particular plan. The plan must then pay you that amount by April 15.

If you ***take out the excess by April 15,*** do not again include it in your gross income. Any ***income*** on the excess taken out is taxable in the tax year in which you take it out. Neither the excess nor the income is subject to the additional 10% tax on distributions before age 59 ½.

If you take out ***part*** of the excess deferral and the income on it, allocate the distribution proportionately between the excess deferral and the income.

If you ***do not take out the excess amount,*** you cannot include it in your cost of the contract even though you included it in your gross income. Therefore, you are taxed twice on the excess deferral left in the plan—once when you contribute it, and again when you receive it as a distribution.

Reporting a corrective distribution of an excess deferral. Although you must report excess deferrals on your return as wages, your employer does not include them as wages on the Form W–2 you receive. File Form 1040 to add the excess deferral amount to your wages on line 7. Do not use Form 1040A or Form 1040EZ to report corrective distributions of excess deferral amounts.

If you received a distribution in 1996 of a 1996 excess deferral, you should receive a 1996 Form 1099–R with the code ''8'' in box 7. Report the excess deferral on your 1996 income tax return.

If a corrective distribution was made by April 15, 1996 for an excess deferral made in 1995, you should receive a 1996 Form 1099–R with the code ''P'' in box 7. If the distribution was for 1994, the code ''D'' should be in box

7. If you did not report the excess deferral on your return for the earlier year, you must file an amended return on Form 1040X.

If you received the distribution in 1996 of income earned on an excess deferral, you should receive a 1996 Form 1099–R with a code ''8'' in box 7.

Report a ***loss*** on a corrective distribution of an excess deferral in the year the excess amount (reduced by the loss) is distributed to you. Include the loss as a negative amount on line 21 (Form 1040) and label it ''Loss on Excess Deferral Distribution. ''

Section 501(c)(18) contributions. Wages shown on your Form W–2 should not have been reduced for contributions you made to a section 501(c)(18) retirement plan. The amount you contributed should be identified with code ''H'' in box 13 of your W-2 form. You may deduct this amount subject to the limits that apply. Include your deduction in the total on line 30. Enter the amount and ''501(c)(18)'' on the dotted line next to line 30.

Section 457 plans—deferred compensation plans of state and local governments and tax-exempt organizations. If you work for a state or local government or tax-exempt organization, you may participate in an eligible deferred compensation plan. You are not taxed currently on your pay that is deferred under the plan. You or your beneficiary are taxed on this deferred pay only when it is distributed or made available to either of you.

Distributions of deferred pay are not eligible for the 5– or 10–year tax option or rollover treatment, both discussed later, or the death benefit exclusion, discussed earlier, for employees dying before August 21, 1996.

To find out if your plan is an eligible plan, check with your employer. However, the following are ***not*** treated as section 457 plans:

1) Bona fide vacation leave, sick leave, compensatory time, severance pay, disability pay, or death benefit plans,
2) Nonelective deferred compensation plans for nonemployees (independent contractors), or
3) Deferred compensation plans maintained by churches for church employees.

After December 31, 1996, length of service award plans to bona fide volunteer firefighters and emergency medical personnel are not treated as section 457 plans.

Limit on deferrals under section 457 plans. If you are a participant in a section 457 plan, you can generally set aside no more than $\frac{1}{3}$ of your includible compensation, up to $7,500 each year. Your plan may also allow a special catch-up limit of up to $15,000 for each of your last 3 years of service before reaching normal retirement age. Amounts you defer under the other elective deferrals discussed earlier may affect your limits under section 457 plans. Amounts you defer under section 457 plans may affect the amount you can defer in tax-sheltered annuities under the special limit discussed earlier.

Excess annual additions. The annual contribution to certain retirement plans is generally limited to the lesser of 25% of compensation or $30,000. Under certain circumstances, contributions that exceed these limits (excess annual additions) may be corrected by a distribution of your elective deferrals or a return of your after-tax contributions and earnings from these contributions.

A corrective payment of excess annual additions consisting of elective deferrals or earnings from your after-tax contributions is fully taxable in the year paid. It cannot be rolled over to another qualified retirement plan or to an IRA. It is not subject to the tax on early distributions. A corrective payment consisting of your after-tax contributions is not taxable.

If you received a corrective payment of excess annual additions, you should receive a separate Form 1099–R for the year of the payment with the code ''E'' in box 7. Report the total payment shown in box 1 of Form 1099–R on line 16a of Form 1040. Report the taxable amount shown in box 2a of Form 1099–R on line 16b of Form 1040.

Loans Treated as Distributions

If you borrow money from an employer's qualified pension or annuity plan, tax-sheltered annuity program, or government plan, you may have to treat the loan as a nonperiodic distribution. This also applies if you borrow from a contract purchased under any of these plans. You must treat the loan this way unless it comes under the exception explained below. This means that you may have to include all or part of the amount borrowed in your income under the rules discussed earlier.

This treatment also applies to the value of any part of your interest in any of these plans that you pledge or assign (or agree to pledge or assign). Further, it may apply if you renegotiate, extend, renew, or revise a loan that came under the exception explained below. If the altered loan no longer qualifies for the exception, you must treat the outstanding balance of the loan as a distribution on the date of the transaction.

Exception for loans repayable in 5 years and home loans. If by the terms of the loan described above you must repay it within 5 years (and you do not extend it by renegotiation or other means), only part of the loan might be treated as a distribution. A loan you use to buy your main home does not have to be repaid within 5 years.

You treat the loan as a distribution only to the extent that the outstanding balances of all your loans from all plans of your employer and certain related employers exceed the lesser of:

1) $50,000, or
2) Half the present value (but not less than $10,000) of your nonforfeitable accrued benefit under the plan, determined without regard to any accumulated deductible employee contributions.

You must reduce the $50,000 amount above if you already had an outstanding loan from the plan during the 1–year period ending the day before you took out the loan. The amount of the reduction is your highest outstanding loan balance during that period minus the outstanding balance on the date you took out the new loan. If this amount is zero or less, ignore it.

Level payments required. This exception applies only if the loan terms require substantially level payments made at least quarterly over the life of the loan.

Related employers and related plans. Treat separate employers' plans as plans of a single employer if they are so treated under other qualified retirement plan rules because the employers are related. You must treat all plans of a single employer as one plan.

Employers are related if they are:

1) Members of a controlled group of corporations,

2) Businesses under common control, or

3) Members of an affiliated service group.

An affiliated service group generally is two or more service organizations whose relationship involves an ownership connection. Their relationship also includes the regular or significant performance of services by one organization for or in association with another.

Denial of interest deduction. If the loan qualifies for the exception, you cannot deduct any of the interest on the loan during any period that:

1) The loan is secured by amounts from elective deferrals under a qualified cash or deferred arrangement (section 401(k) plan) or a tax-sheltered annuity, or

2) You are a key employee as defined in Internal Revenue Code section 416(i).

Loans from nonqualified plans. The following explanation applies to a loan from a retirement plan that is ***not*** a qualified pension or annuity plan, tax-sheltered annuity program, or government plan.

If you borrow money from an annuity, endowment, or life insurance contract before the annuity starting date, you must treat the loan as a nonperiodic distribution. This treatment also generally applies to any part of the contract's value that you pledge or assign (or agree to pledge or assign) before the annuity starting date.

To figure how much of the amount borrowed or pledged must be included in your income, use the rules explained earlier under *Distribution before annuity starting date.* See the explanations under *Distributions from plans other than qualified retirement plans* and *Exceptions.* Increase your investment in the contract by the amount you include in your income, unless the distribution is described under *Exceptions*. In that case, reduce your investment in the contract by the amount you do not include in your income.

Transfers of Annuity Contracts

If you transfer without full and adequate consideration an annuity contract issued after April 22, 1987, you are treated as receiving a nonperiodic distribution. The distribution equals the excess of:

1) The cash surrender value of the contract at the time of transfer, over

2) The cost of the contract at that time.

This rule does not apply to transfers between spouses or transfers incident to a divorce.

No gain or loss is recognized if you exchange an annuity contract for another if the insured or annuitant remains the same. However, the gain on the sale of an annuity contract is ordinary income if the gain is due to interest accumulated on the contract. Gain due to interest is also ordinary income if the contract is exchanged for a life insurance or endowment contract.

If you transfer a full or partial interest in a tax-sheltered annuity that is not subject to restrictions on early distributions to another tax-sheltered annuity, the transfer qualifies for nonrecognition of gain or loss.

If you exchange an annuity contract issued by a life insurance company that is subject to a rehabilitation, conservatorship, or similar state proceeding for an annuity contract issued by another life insurance company, the exchange qualifies for nonrecognition of gain or loss. The exchange is tax free even if the new contract is funded by two or more payments from the old annuity contract. This also applies to an exchange of a life insurance contract for a life insurance, endowment, or annuity contract.

In general, a transfer or exchange in which you receive cash proceeds from the surrender of one policy and invest the cash in another policy does not qualify for nonrecognition of gain or loss. However, no gain or loss is recognized if the cash distribution is from an insurance company that is subject to a rehabilitation, conservatorship, insolvency, or similar state proceeding. For the nontaxable transfer rules to apply, you must also reinvest the proceeds in a single policy or contract issued by another insurance company and the exchange of the policies or contracts must otherwise qualify for nonrecognition. You must withdraw all the cash you can and reinvest it within 60 days. If the cash distribution is less than required for full settlement, you must assign all rights to any future distributions to the new issuer.

If you want nonrecognition treatment for the cash distribution, you must give the new issuer the following information:

1) The amount of cash distributed,

2) The amount of the cash reinvested in the new policy or contract, and

3) Your investment in the old policy or contract on the date of the initial distribution.

You must attach the following items to your timely filed income tax return for the year of the initial distribution.

1) A copy of the statement you gave to the new issuer, and
2) A statement that contains the words "ELECTION UNDER REV. PROC. 92–44, " the new issuer's name, and the policy number or similar identifying information for the new policy or contract.

If you acquire an annuity contract in a tax-free exchange for another annuity contract, the date of purchase of the annuity you acquired in the exchange is the date you purchased the annuity you exchanged. This rule applies for determining if the annuity qualifies as an immediate annuity and for the tax on early distributions.

Lump-Sum Distributions

If you receive a lump-sum distribution from a qualified retirement plan, you may be able to elect optional methods of figuring the tax on the distribution. The part from active participation in the plan before 1974 may qualify for capital gain treatment. The part from participation after 1973 (and any part from participation before 1974 that you do not report as capital gain) is ordinary income. You may be able to use the 5– or 10–year tax option, discussed later, to figure tax on the ordinary income part.

You can use these tax options to figure your tax on a lump-sum distribution only if the plan participant was born before 1936.

TIP *You may be able to figure the tax on a lump-sum distribution under the 5-year tax option even if the plan participant was born after 1935. You can do this only if the distribution is made on or after the date the participant reached age 59 ½ and the distribution otherwise qualifies.*

Distributions that qualify. A lump-sum distribution is paid within a single tax year. It is the distribution or payment of a plan participant's entire balance from all of the employer's qualified plans of one kind (pension, profit-sharing, or stock bonus plans). The participant's entire balance does not include deductible voluntary employee contributions or certain forfeited amounts.

The distribution is paid:

1) Because of the plan participant's death,
2) After the participant reaches age 59½,
3) Because the participant, if an employee, separates from service, or
4) After the participant, if a self-employed individual, becomes totally and permanently disabled.

Reemployment. A separated employee's vested percentage in his or her retirement benefit may increase if he or she is rehired by the employer. This possibility does not prevent the distribution from qualifying as a lump-sum distribution. However, if an employee's vested percentage in benefits previously subject to lump-sum treatment increases after reemployment, the employee must recapture the tax saved by applying lump-sum treatment as provided by Treasury regulations.

Alternate payee under qualified domestic relations order. If you receive a distribution as an alternate payee under a qualified domestic relations order (discussed earlier under *General Information*), you may be able to choose the optional tax computations for it. You can make this choice for a distribution that would be treated as a lump-sum distribution had it been received by your spouse or former spouse (the plan participant). However, for this purpose, the balance to your credit does not include any amount payable to the plan participant.

More than one recipient. One or all of the recipients of a lump-sum distribution can use the optional tax computations. See *Multiple Recipients of a Lump-Sum Distribution* in the instructions for Form 4972.

Distributions that do not qualify. The following distributions do not qualify as lump-sum distributions.

1) A distribution of your ***deductible voluntary employee contributions*** and any net earnings on these contributions. A deductible voluntary employee contribution is a contribution that:
   a) Was made by the employee in a tax year beginning after 1981 and before 1987 to a qualified employer plan or a government plan that allows such contributions,
   b) Was not designated by the employee as nondeductible, and
   c) Was not mandatory.
2) U.S. Retirement Plan Bonds distributed with a lump sum.
3) Any distribution made during the first 5 tax years that the employee was a participant in the plan, unless it was made because the employee died.
4) The current actuarial value of an annuity contract included in a lump-sum distribution. (However, this value is used to figure tax on the ordinary income part of the distribution under the 5– or 10–year tax option method.)
5) A distribution to a 5% owner that is subject to a penalty because it exceeds the benefits provided under the plan formula.
6) A distribution from an IRA.
7) A distribution of the redemption proceeds of bonds rolled over tax free to the plan from a qualified bond purchase plan.
8) A distribution from a qualified plan if the plan participant or his or her surviving spouse previously received an eligible rollover distribution from the same plan (or another plan of the employer that must be combined with that plan for the lump-sum

distribution rules) and the previous distribution was rolled over tax free to another qualified plan or to an IRA.

9) A corrective distribution of excess deferrals, excess contributions, excess aggregate contributions, or excess annual additions.
10) A lump-sum credit or payment from the Federal Civil Service Retirement System (or the Federal Employees Retirement System).
11) A distribution from a tax-sheltered annuity.
12) A distribution from a qualified plan if any part of the distribution is rolled over tax free to another qualified plan or IRA.
13) A distribution from a privately purchased commercial annuity.
14) A distribution from a section 457 deferred compensation plan of a state or local government or a tax-exempt organization.

How to treat the distribution. If you receive a lump-sum distribution from a qualified retirement plan, you may have various options for how you treat the taxable part. You can:

1) Roll over all or part of the distribution. No tax is currently due on the part rolled over. See *Rollovers,* later.
2) Report the entire taxable part of the distribution as ordinary income on your tax return.
3) Report the part of the distribution from participation before 1974 as a capital gain and the amount from participation after 1973 as ordinary income (if you qualify).
4) Use the 5– or 10–year tax option, discussed later, to figure the tax on the ordinary income part of the distribution (from participation after 1973) if you qualify. Report the capital gain part (from participation before 1974) on Form 4972, Part II (if you qualify).
5) Use the 5– or 10–year tax option to figure the tax on the total taxable amount (if you qualify).

These various options are explained in the following discussions.

Electing optional lump-sum treatment. You can choose to use the 5– or 10–year tax option or capital gain treatment only once after 1986 for any plan participant. If you make this choice, you cannot use any of these optional methods for any future distributions for the participant.

Complete Form 4972 and attach it to your Form 1040 income tax return if you want to use the tax options. If you received more than one lump-sum distribution for a plan participant during the year, you must add them together in your computation.

If you and your spouse are filing a joint return and you both have received a lump-sum distribution, each of you should complete a separate Form 4972. Then add the separate taxes from the Forms 4972 and enter the total on line 38, Form 1040.

Time for choosing. You must decide to use the tax options before the end of the time, including extensions, for making a claim for credit or refund of tax. This is usually 3 years after the date the return was filed or 2 years after the date the tax was paid, whichever is later. (Returns filed before April 15 are considered filed on April 15.)

Changing your mind. You can change your mind and decide not to use the tax options within the time period just discussed. If you change your mind, file Form 1040X, *Amended U.S. Individual Income Tax Return,* with a statement saying you do not want to use the optional lump-sum treatment. You must pay any additional taxes due to the change with the Form 1040X.

Taxable and nontaxable parts of the distribution. You may recover your ***cost*** in the lump sum tax free. In general, your cost consists of:

1) The plan participant's total nondeductible contributions to the plan,
2) The total of the plan participant's taxable costs of any life insurance contract distributed,
3) Any employer contributions that were taxable to the plan participant,
4) Repayments of loans that were taxable to the plan participant,
5) The net unrealized appreciation in employer's securities distributed, and
6) The death benefit exclusion, if it applies (see *Death benefit exclusion* under *Investment in the Contract (Cost),* earlier).

You must reduce this cost by amounts previously distributed tax free.

The total taxable amount of a lump-sum distribution is the part that is the employer's contribution and income earned on your account.

Losses. You may be able to take a loss on your return if you receive a lump-sum distribution that is less than the plan participant's cost in the lump-sum. You must receive the distribution entirely in cash.

To claim the loss, you must itemize deductions on Schedule A (Form 1040). Show the loss as a miscellaneous deduction (subject to the 2%-of-adjusted- gross-income limit). The amount that you may claim as a loss is the difference between the participant's cost and the amount of the distribution.

Distributions of employer securities. If your distribution includes securities in the employer's company, these securities may have increased in value while they were in the trust. ''Securities'' includes stocks, bonds, registered debentures, and debentures with interest coupons attached. This increase in value is called ''net unrealized appreciation'' (NUA).

If the distribution is a lump sum, you are not taxed on the NUA when you get the securities, unless you elect to include it in your gross income. However, you must include the NUA in the amount subject to the tax on excess distributions (discussed later), whether or not you elect to include it in your gross income.

If the distribution is not a lump sum, this tax deferral applies only to the extent the NUA results from employee contributions. This treatment does not apply to a distribution based on deductible voluntary employee contributions (defined earlier). The NUA on which tax is deferred should be shown in box 6 of the Form 1099–R you receive from the payer of the distribution.

You can choose to be taxed on the NUA. Make this choice on the tax return on which you have to include the distribution. If you choose to be taxed on the NUA and there is an amount in box 3 of the Form 1099–R, part of the NUA will qualify for capital gain treatment. See the instructions for Form 4972.

When you sell or exchange employer securities with untaxed NUA, any gain is ***long-term*** capital gain up to the amount of the NUA. This is true no matter how long you held the securities. Any gain that is more than the NUA is a long-term or short-term capital gain, depending on how long you held the securities after the distribution.

Losses. If all you receive is worthless securities, you can claim a loss of the plan participant's total contributions to the plan. To do so, you must itemize your deductions on Schedule A (Form 1040) and claim the loss as a miscellaneous deduction (subject to the 2%-of-adjusted-gross-income limit).

You cannot claim a loss if all you receive is stock with a fair market value that is less than the plan participant's total contributions to the plan. You can claim a loss only if you sell or exchange the stock for less than the plan participant's contributions.

Capital Gain Treatment

Only a plan participant who was born before 1936 can treat part of the taxable portion of a lump-sum distribution as a capital gain. This gain is taxable at a 20% rate. This treatment applies to the portion you receive for the participation in the plan before 1974. You can elect this treatment only once for any plan participant. Use Form 4972, *Tax on Lump-Sum Distributions,* to make this choice.

Figuring the capital gain and ordinary income parts. Generally, figure the capital gain and ordinary income parts of a lump-sum distribution by using the following formulas:

$$\text{Total taxable amount} \times \frac{\text{Months of active participation before 1974}}{\text{Total months of active participation}} = \text{Capital Gain}$$

$$\text{Total taxable amount} \times \frac{\text{Months of active participation after 1973}}{\text{Total months of active participation}} = \text{Ordinary Income}$$

In figuring the months of active participation before 1974, count as 12 months any part of a calendar year in which the plan participant actively participated under the plan. For active participation after 1973, count as one month any part of a calendar month in which the participant actively participated in the plan.

The capital gain part should be shown in box 3 of Form 1099–R, *Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.,* or other statement given to you by the payer of the distribution.

Allocating death benefit exclusion. If you can take the death benefit exclusion and make the capital gain election, you must allocate the death benefit exclusion. Allocate the exclusion between the ordinary income and capital gain parts of the distribution. Follow the Form 4972 instructions for Part II, line 6, to figure the allocation.

For information on the death benefit exclusion, see *Investment in the Contract (Cost)* under *Taxation of Periodic Payments,* earlier.

Allocating federal estate tax. If you become liable for any federal estate tax (discussed under *Survivors and Beneficiaries,* later) because of the lump-sum distribution and you make the capital gain election, you must allocate the estate tax. Allocate it between the ordinary income and capital gain parts of the distribution. Follow the Form 4972 instructions for Part II, line 6, to figure the allocation and your entry on line 18 of Part III. If you do not make the capital gain election, enter on line 18 the estate tax attributable to both parts of the lump-sum distribution. For information on how to figure the estate tax attributable to the lump-sum distribution, get the instructions for Form 706.

5– or 10–Year Tax Option

The 20% capital gain election and the 5–year and 10–year tax option are special formulas used to figure a separate tax on a qualified lump-sum distribution only for the year in which the distribution is received. You pay the tax only once. You do not pay the tax over the next 5 or 10 years. This tax is in addition to the regular tax figured on your other income. The use of either option may result in a smaller tax than you would pay by including the taxable amount of the distribution as ordinary income in figuring your regular tax.

You can choose to use the 5– or 10–year tax option for the ordinary income part of the distribution (box 2a minus box 3, Form 1099–R). You also can treat the capital gain part of the distribution as ordinary income under the optional method if you ***do not*** choose capital gain treatment for that part. You must use the same method (either the 5–year or 10–year tax option) for all distributions received in the tax year for a plan participant. You cannot make more than one choice for distributions for a plan participant.

Disregard community property laws for the 5– or 10–year tax option.

If you choose the 5–year tax option, figure the tax computed on Form 4972 using 1996 tax rates. If you choose the 10–year tax option, figure the tax on Form 4972 using the special 1986 tax rates shown in the Form 4972 Instructions. Do not use the tax rates shown in the 1986 tax forms instructions.

Who can use the method. Any individual, estate, or trust receiving a lump-sum distribution on behalf of a plan participant who was born before 1936 can use the 5– or 10–year tax option. The plan participant who was at least age 59 1/2 in 1996 can, however, use the 5-year tax option although he or she was born after 1935. This does not apply to the 10-year tax option.

The individual, estate, or trust must make the choice for that portion of the distribution each received. However, if two or more trusts receive the distribution, the plan participant or the personal representative of a deceased participant must make the choice.

Examples

The following examples show how to figure the separate tax on Form 4972.

Example 1. In 1996 Robert Smith, who was born in 1931, retired from Crabtree Corporation. Rather than receiving a lifetime pension, Robert withdrew the entire amount to his credit from the plan. In December 1996, he received a total distribution of $175,000 ($25,000 of employee contributions plus $150,000 of employer contributions and earnings on all contributions).

The payer gave Robert a Form 1099–R, which shows the capital gain part of the distribution to be $10,000. Robert elects 20% capital gain treatment for the part attributable to participation before 1974. A filled-in copy of Robert's Form 1099–R and Form 4972 follows. He enters $10,000 on Form 4972, Part II, line 6, and $2,000 ($10,000 × 20%) on Part II, line 7.

The ordinary income part of the distribution is $140,000 ($150,000 minus $10,000). Robert elects to figure the tax on this part using the 5– or 10–year tax option. He enters $140,000 on Form 4972, Part III, line 8. Then he completes Form 4972 and enters the tax of $24,270 on line 38 of his Form 1040.

Example 2. Mary Brown, age 61, sold her business in 1996. She withdrew her entire interest in the profit-sharing plan (a qualified plan) that she had set up as the sole proprietor.

The cash part of the amount distributed to Mary, $160,000, is all ordinary income and is shown on her Form 1099–R at the end of this discussion. She chooses to figure the tax on this amount using the 5– or 10–year tax option. Mary also received an annuity contract as part of the distribution from the plan. Box 8, Form 1099–R, shows that the current actuarial value of the annuity was $10,000. She enters these figures on Form 4972, which follows.

After completing Form 4972, she enters the tax of $28,070 on line 38, Form 1040.

☐ CORRECTED (if checked)

PAYER'S name, street address, city, state, and ZIP code Crabtree Corporation Employees' Pension Plan 1111 Main Street Anytown, Texas 75000		1 Gross distribution $ 175000.00 2a Taxable amount $ 150000.00	OMB No. 1545-0119 1996 Form 1099-R	**Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.**
		2b Taxable amount not determined ☐	Total distribution ☒	**Copy B** **Report this income on your Federal tax return. If this form shows Federal income tax withheld in box 4, attach this copy to your return.**
PAYER'S Federal identification number 00-0000000	RECIPIENT'S identification number 002-00-3456	3 Capital gain (included in box 2a) $ 10000.00	4 Federal income tax withheld $ 30000.00	
RECIPIENT'S name Robert C. Smith		5 Employee contributions or insurance premiums $ 25000.00	6 Net unrealized appreciation in employer's securities $	
Street address (including apt. no.) 911 Mill Way		7 Distribution code 7A | IRA/SEP ☐	8 Other $ %	This information is being furnished to the Internal Revenue Service.
City, state, and ZIP code Hometown, Texas 75001		9a Your percentage of total distribution %	9b Total employee contributions $	
Account number (optional)		10 State tax withheld $ $	11 State/Payer's state no.	12 State distribution $ $
		13 Local tax withheld $ $	14 Name of locality	15 Local distribution $ $

Form 1099-R Department of the Treasury - Internal Revenue Service

Form **4972**

Department of the Treasury
Internal Revenue Service

Tax on Lump-Sum Distributions

From Qualified Retirement Plans

▶ Attach to Form 1040 or Form 1041. ▶ See separate instructions.

OMB No. 1545-0193

1996

Attachment Sequence No. 28

Name of recipient of distribution: *Robert C. Smith*

Identifying number: *002-00-3456*

Part I **Complete this part to see if you qualify to use Form 4972**

			Yes	No
1	Was this a distribution of a plan participant's entire balance from all of an employer's qualified plans of one kind (pension, profit-sharing, or stock bonus)? If "No," do not use this form.	1	✓	
2	Did you roll over any part of the distribution? If "Yes," do not use this form.	2		✓
3	Was this distribution paid to you as a beneficiary of a plan participant who died after reaching age 59½ (or who had been born before 1936)?	3		✓
4	Were you a plan participant who received this distribution after reaching age 59½ and having been in the plan for at least 5 years before the year of the distribution?	4	✓	
	If you answered "No" to both questions 3 and 4, do not use this form.			
5a	Did you use Form 4972 after 1986 for a previous distribution from your own plan? If "Yes," do not use this form for a 1996 distribution from your own plan	5a		✓
b	If you are receiving this distribution as a beneficiary of a plan participant who died, did you use Form 4972 for a previous distribution received for that plan participant after 1986? If "Yes," you may not use the form for this distribution	5b		

Part II **Complete this part to choose the 20% capital gain election** (See instructions.) Do not complete this part unless the participant was born before 1936.

6	Capital gain part from box 3 of Form 1099-R	6	10,000
7	Multiply line 6 by 20% (.20)	7	2,000
	If you also choose to use Part III, go to line 8. Otherwise, include the amount from line 7 in the total on Form 1040, line 38, or Form 1041, Schedule G, line 1b, whichever applies.		

Part III **Complete this part to choose the 5- or 10-year tax option** (See instructions.)

8	Ordinary income from Form 1099-R, box 2a minus box 3. If you did not complete Part II, enter the taxable amount from box 2a of Form 1099-R	8	140,000
9	Death benefit exclusion for a beneficiary of a plan participant who died before August 21, 1996	9	
10	Total taxable amount. Subtract line 9 from line 8	10	140,000
11	Current actuarial value of annuity (from Form 1099-R, box 8)	11	
12	Adjusted total taxable amount. Add lines 10 and 11. If this amount is $70,000 or more, skip lines 13 through 16, and enter this amount on line 17	12	140,000
13	Multiply line 12 by 50% (.50), but do not enter more than $10,000 — 13		
14	Subtract $20,000 from line 12. If the result is less than zero, enter -0- — 14		
15	Multiply line 14 by 20% (.20) — 15		
16	Minimum distribution allowance. Subtract line 15 from line 13	16	
17	Subtract line 16 from line 12	17	140,000
18	Federal estate tax attributable to lump-sum distribution	18	
19	Subtract line 18 from line 17	19	140,000
	If line 11 is blank, skip lines 20 through 22 and go to line 23.		
20	Divide line 11 by line 12 and enter the result as a decimal	20	
21	Multiply line 16 by the decimal on line 20	21	
22	Subtract line 21 from line 11	22	

For Paperwork Reduction Act Notice, see separate instructions. Cat. No. 13187U Form **4972** (1996)

Part III **5- or 10-year tax option—CONTINUED**

5-year tax option	23	Multiply line 19 by 20% (.20)	23	28,000
	24	Tax on amount on line 23. Use the Tax Rate Schedule for the 5-Year Tax Option in the instructions	24	4,720
	25	Multiply line 24 by five (5). If line 11 is blank, skip lines 26 through 28, and enter this amount on line 29	25	23,600
	26	Multiply line 22 by 20% (.20) — 26		
	27	Tax on amount on line 26. Use the Tax Rate Schedule for the 5-Year Tax Option in the instructions — 27		
	28	Multiply line 27 by five (5)	28	
	29	Subtract line 28 from line 25. (Multiple recipients, see page 3 of the instructions.)	29	23,600
10-year tax option		**Note:** *Complete lines 30 through 36 ONLY if the participant was born before 1936. Otherwise, enter the amount from line 29 on line 37.*		
	30	Multiply line 19 by 10% (.10)	30	14,000
	31	Tax on amount on line 30. Use the Tax Rate Schedule for the 10-Year Tax Option in the instructions	31	2,227
	32	Multiply line 31 by ten (10). If line 11 is blank, skip lines 33 through 35, and enter this amount on line 36	32	22,270
	33	Multiply line 22 by 10% (.10) — 33		
	34	Tax on amount on line 33. Use the Tax Rate Schedule for the 10-Year Tax Option in the instructions — 34		
	35	Multiply line 34 by ten (10)	35	
	36	Subtract line 35 from line 32. (Multiple recipients, see page 3 of the instructions.)	36	22,270
	37	Compare lines 29 and 36. Generally, you should enter the smaller amount here (see instructions) ▶	37	22,270
	38	Tax on lump-sum distribution. Add lines 7 and 37. Also, include in the total on Form 1040, line 38, or Form 1041, Schedule G, line 1b, whichever applies ▶	38	24,270

☐ CORRECTED (if checked)

PAYER'S name, street address, city, state, and ZIP code Brown's Real Estate Profit-Sharing Plan 2101 Chelsea Court Anytown, Nevada 89300		1 Gross distribution $ 160000.00 2a Taxable amount $ 160000.00	OMB No. 1545-0119 1996 Form 1099-R	**Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.**
		2b Taxable amount not determined ☐	Total distribution ☒	**Copy B** **Report this income on your Federal tax return. If this form shows Federal income tax withheld in box 4, attach this copy to your return.**
PAYER'S Federal identification number 00-0000000	RECIPIENT'S identification number 005-00-6789	3 Capital gain (included in box 2a) $	4 Federal income tax withheld $ 32000.00	
RECIPIENT'S name Mary Brown		5 Employee contributions or insurance premiums $	6 Net unrealized appreciation in employer's securities $	
Street address (including apt. no.) 12 Mill Avenue		7 Distribution code 7A / IRA/SEP ☐	8 Other $ 10000.00 %	This information is being furnished to the Internal Revenue Service.
City, state, and ZIP code Hometown, Nevada 89301		9a Your percentage of total distribution %	9b Total employee contributions $	
Account number (optional)		10 State tax withheld $ $	11 State/Payer's state no.	12 State distribution $ $
		13 Local tax withheld $ $	14 Name of locality	15 Local distribution $ $

Form 1099-R Department of the Treasury - Internal Revenue Service

Form **4972**

Department of the Treasury
Internal Revenue Service

Tax on Lump-Sum Distributions

From Qualified Retirement Plans

▶ Attach to Form 1040 or Form 1041. ▶ See separate instructions.

OMB No. 1545-0193

1996

Attachment Sequence No. 28

Name of recipient of distribution: Mary Brown

Identifying number: 005-00-6789

Part I **Complete this part to see if you qualify to use Form 4972**

			Yes	No
1	Was this a distribution of a plan participant's entire balance from all of an employer's qualified plans of one kind (pension, profit-sharing, or stock bonus)? If "No," do not use this form	1	✓	
2	Did you roll over any part of the distribution? If "Yes," do not use this form	2		✓
3	Was this distribution paid to you as a beneficiary of a plan participant who died after reaching age 59½ (or who had been born before 1936)?	3		✓
4	Were you a plan participant who received this distribution after reaching age 59½ and having been in the plan for at least 5 years before the year of the distribution?	4	✓	
	If you answered "No" to both questions 3 and 4, do not use this form.			
5a	Did you use Form 4972 after 1986 for a previous distribution from your own plan? If "Yes," do not use this form for a 1996 distribution from your own plan	5a		✓
b	If you are receiving this distribution as a beneficiary of a plan participant who died, did you use Form 4972 for a previous distribution received for that plan participant after 1986? If "Yes," you may not use the form for this distribution	5b		

Part II **Complete this part to choose the 20% capital gain election** (See instructions.) Do not complete this part unless the participant was born before 1936.

6	Capital gain part from box 3 of Form 1099-R	6	
7	Multiply line 6 by 20% (.20)	7	
	If you also choose to use Part III, go to line 8. Otherwise, include the amount from line 7 in the total on Form 1040, line 38, or Form 1041, Schedule G, line 1b, whichever applies.		

Part III **Complete this part to choose the 5- or 10-year tax option** (See instructions.)

8	Ordinary income from Form 1099-R, box 2a minus box 3. If you did not complete Part II, enter the taxable amount from box 2a of Form 1099-R	8	160,000
9	Death benefit exclusion for a beneficiary of a plan participant who died before August 21, 1996	9	
10	Total taxable amount. Subtract line 9 from line 8	10	160,000
11	Current actuarial value of annuity (from Form 1099-R, box 8)	11	10,000
12	Adjusted total taxable amount. Add lines 10 and 11. If this amount is $70,000 or more, skip lines 13 through 16, and enter this amount on line 17	12	170,000
13	Multiply line 12 by 50% (.50), but do not enter more than $10,000 (line 13)		
14	Subtract $20,000 from line 12. If the result is less than zero, enter -0- (line 14)		
15	Multiply line 14 by 20% (.20) (line 15)		
16	Minimum distribution allowance. Subtract line 15 from line 13	16	
17	Subtract line 16 from line 12	17	170,000
18	Federal estate tax attributable to lump-sum distribution	18	
19	Subtract line 18 from line 17	19	170,000
	If line 11 is blank, skip lines 20 through 22 and go to line 23.		
20	Divide line 11 by line 12 and enter the result as a decimal	20	.0588
21	Multiply line 16 by the decimal on line 20	21	-0-
22	Subtract line 21 from line 11	22	10,000

For Paperwork Reduction Act Notice, see separate instructions. Cat. No. 13187U Form **4972** (1996)

Part III **5- or 10-year tax option—CONTINUED**

5-year tax option	23	Multiply line 19 by 20% (.20)			23	34,000
	24	Tax on amount on line 23. Use the Tax Rate Schedule for the 5-Year Tax Option in the instructions			24	6,400
	25	Multiply line 24 by five (5). If line 11 is blank, skip lines 26 through 28, and enter this amount on line 29			25	32,000
	26	Multiply line 22 by 20% (.20)	26	2,000		
	27	Tax on amount on line 26. Use the Tax Rate Schedule for the 5-Year Tax Option in the instructions	27	300		
	28	Multiply line 27 by five (5)			28	1,500
	29	Subtract line 28 from line 25. (Multiple recipients, see page 3 of the instructions.)			29	30,500
10-year tax option		**Note:** *Complete lines 30 through 36 ONLY if the participant was born before 1936. Otherwise, enter the amount from line 29 on line 37.*				
	30	Multiply line 19 by 10% (.10)			30	17,000
	31	Tax on amount on line 30. Use the Tax Rate Schedule for the 10-Year Tax Option in the instructions			31	2,917
	32	Multiply line 31 by ten (10). If line 11 is blank, skip lines 33 through 35, and enter this amount on line 36			32	29,170
	33	Multiply line 22 by 10% (.10)	33	1,000		
	34	Tax on amount on line 33. Use the Tax Rate Schedule for the 10-Year Tax Option in the instructions	34	110		
	35	Multiply line 34 by ten (10)			35	1,100
	36	Subtract line 35 from line 32. (Multiple recipients, see page 3 of the instructions.)			36	28,070
	37	Compare lines 29 and 36. Generally, you should enter the smaller amount here (see instructions) ▶			37	28,070
	38	Tax on lump-sum distribution. Add lines 7 and 37. Also, include in the total on Form 1040, line 38, or Form 1041, Schedule G, line 1b, whichever applies ▶			38	28,070

Rollovers

A rollover is a withdrawal of cash or other assets from one qualified retirement plan or IRA and its reinvestment in another qualified retirement plan or IRA. Do not include the amount rolled over in your income and do not take a deduction for it. The amount rolled over is taxable later as the new retirement plan or IRA pays that amount to you. If you roll over amounts into an IRA, subsequent distributions of these amounts from the IRA do not qualify for the capital gain treatment or 5– or 10–year tax option discussed earlier.

A qualified retirement plan is a qualified pension, profit-sharing, or stock bonus plan, or a qualified annuity plan. To determine whether your plan is a qualified plan, check with your employer or the plan administrator. For information on rollovers from tax-sheltered annuities, see Publication 571.

Self-employed individuals are generally treated as employees for rules on the tax treatment of distributions, including rollovers.

Eligible rollover distributions. An eligible rollover distribution is any distribution of all or any part of the balance to your credit in a qualified retirement plan ***except***:

1) The nontaxable part of a distribution (such as your after-tax contributions) other than the net unrealized appreciation from employer securities described earlier in *Distributions of employer securities* under *Lump-Sum Distributions* ,
2) Any of a series of substantially equal distributions paid at least once a year over:
   a) Your lifetime or life expectancy,
   b) The joint lives or life expectancies of you and your beneficiary, or
   c) A period of 10 years or more,
3) A required minimum distribution generally beginning at age 70 $^1/_2$ (described under *Tax on Excess Accumulation,* later),
4) Corrective distributions of excess contributions or excess deferrals, and any income allocable to the excess, or of excess annual additions and any allocable gains (see *Excess Contributions, Deferrals and Annual Additions,* earlier),
5) A loan treated as a distribution because it does not satisfy certain requirements either when made or later (such as upon default), unless the participant's accrued benefits are reduced (offset) to repay the loan (see *Loans Treated as Distributions,* earlier),
6) Dividends on employer securities, or
7) The cost of life insurance coverage.

In addition, a distribution to the plan participant's beneficiary is not generally treated as an eligible rollover distribution. However, see *Qualified domestic relations order* and *Rollover by surviving spouse*, later.

Withholding requirements. If an eligible rollover distribution is paid to you, the payer must withhold 20% of it. This applies even if you plan to roll over the distribution to another qualified retirement plan or to an IRA. However, you can avoid withholding by choosing the ***direct rollover option,*** discussed later. Also, see *Choosing the right option* at the end of this discussion.

Exceptions. An eligible rollover distribution is not subject to withholding to the extent it consists of net unrealized appreciation from employer securities that can be excluded from your gross income. (See *Distributions of employer securities* under *Lump-Sum Distributions,* earlier.)

In addition, withholding from an eligible rollover distribution paid to you is not required if:

1) The distribution and all previous eligible rollover distributions you received during your tax year from the same plan (or at the payer's option, from all your employer's plans) total less than $200, or
2) The distribution consists solely of employer securities, plus cash of $200 or less in lieu of fractional shares.

Direct rollover option. You can choose to have any part of an eligible rollover distribution paid directly to another qualified retirement plan that accepts rollover distributions or to an IRA.

No tax withheld. If you choose the direct rollover option, no tax will be withheld from any part of the distribution that is directly paid to the trustee of the other plan. If any part of the eligible rollover distribution is paid to you, the payer must generally withhold 20% of it for income tax.

Payment to you option. If an eligible rollover distribution is paid to you, 20% generally will be withheld for income tax. However, the full amount is treated as distributed to you even though you actually receive only 80%. You must include in income any part (including the part withheld) that you do not roll over within 60 days to another qualified retirement plan or to an IRA.

Partial rollovers. If you receive a lump-sum distribution, it may qualify for special tax treatment. See *Lump-Sum Distributions,* earlier. However, if you roll over any part of the distribution, the part you keep does ***not*** qualify for special tax treatment.

If you are under age 59$^1/_2$ when a distribution is paid to you, you may have to pay a 10% tax (in addition to the regular income tax) on the taxable part, including any tax withheld, that you do not roll over. See *Tax on Early Distributions,* later.

Rolling over more than amount received. If the part of the distribution you want to roll over exceeds (due to the tax withholding) the amount you actually received, you will have to get funds from some other source (such as your savings or borrowed amounts) to add to the amount you actually received.

Example. On January 31, 1997, you receive an eligible rollover distribution of $10,000 from your employer's qualified plan. The payer withholds $2,000, so you actually receive $8,000. If you want to roll over the entire $10,000 to postpone including that amount in your income, you will have to get $2,000 from some other source to add to the $8,000 you actually received. You must complete the rollover by April 1, 1997.

If you roll over only $8,000, you must include in your 1997 income the $2,000 not rolled over. Also, you may be subject to the 10% additional tax on the $2,000 if it was distributed to you before you reached age 59 1/2.

Time for making rollover. You must complete the rollover of an eligible rollover distribution paid to you by the 60th day following the day on which you receive the distribution from your employer's plan.

Frozen deposits. If an amount that was distributed to you from a qualified retirement plan is deposited in an account from which you cannot withdraw it because of either:

1) The bankruptcy or insolvency of any financial institution, or

2) Any requirement imposed by the state in which the institution is located because of the bankruptcy or insolvency (or threat of it) of one or more financial institutions in the state,

that amount is considered a ''frozen deposit'' for the period during which you cannot withdraw it.

A special rule extends the period allowed for a tax-free rollover for frozen deposits. The period during which the amount is a frozen deposit is not counted in the 60–day period allowed for a tax-free rollover into a qualified plan or an IRA. Also, the 60–day period does not end earlier than 10 days after the deposit is no longer a frozen deposit. However, to qualify under this rule, the deposit must be frozen on at least one day during the 60–day rollover period.

Retirement bonds. If you redeem retirement bonds purchased under a qualified bond purchase plan, you can roll over the proceeds that exceed your basis tax free into an IRA or qualified employer plan. Subsequent distributions, however, do not qualify for the 5– or 10–year tax option or capital gain treatment.

Annuity contracts. If an annuity contract was distributed to you by a qualified retirement plan, you can roll over an amount paid under the contract that is otherwise an eligible rollover distribution. For example, you can roll over a single sum payment you receive upon surrender of the contract to the extent it is taxable and is not a required minimum distribution.

Rollovers of property. To roll over an eligible rollover distribution of property, you must either roll over the actual property distributed or sell it and roll over the proceeds. You cannot keep the distributed property and roll over cash or other property.

If you sell the distributed property and roll over all the proceeds, no gain or loss is recognized on the sale. The sale proceeds (including any portion representing an increase in value) are treated as part of the distribution and are not included in your gross income.

If you roll over only part of the proceeds, you are taxed on the part you keep. You must allocate the proceeds you keep between the part representing ordinary income from the distribution (its value upon distribution) and the part representing gain or loss from the sale (its change in value from its distribution to its sale).

Example 1. On September 6, 1996, Paul received an eligible rollover distribution from his employer's noncontributory qualified retirement plan of $50,000 in nonemployer stock. On September 27, 1996, he sold the stock for $60,000. On October 4, 1996, he contributed $60,000 cash to an IRA. Paul does not include either the $50,000 eligible rollover distribution or the $10,000 gain from the sale of the stock in his income. The entire $60,000 rolled over will be ordinary income when he withdraws it from his IRA.

Example 2. The facts are the same as in Example 1, except that Paul sold the stock for $40,000 and contributed $40,000 to the IRA. Paul does not include the $50,000 eligible rollover distribution in his income and does not deduct the $10,000 loss from the sale of the stock. The $40,000 rolled over will be ordinary income when he withdraws it from his IRA.

Example 3. The facts are the same as in Example 1, except that Paul rolled over only $45,000 of the $60,000 proceeds from the sale of the stock. The $15,000 proceeds he did not roll over includes part of the gain from the stock sale. Paul reports $2,500 ($10,000/$60,000 × $15,000) capital gain and $12,500 ($50,000/$60,000 × $15,000) ordinary income.

Example 4. The facts are the same as in Example 2, except that Paul rolled over only $25,000 of the $40,000 proceeds from the sale of the stock. The $15,000 proceeds he did not roll over includes part of the loss from the stock sale. Paul reports $3,750 ($10,000/$40,000 × $15,000) capital loss and $18,750 ($50,000/$40,000 × $15,000) ordinary income.

Property and cash distributed. If both cash and property were distributed and you did not roll over the entire distribution, you may designate what part of the rollover is allocable to the cash distribution and what part is allocable to the proceeds from the sale of the distributed property. If the distribution included an amount that is not taxable (other than net unrealized appreciation in employer securities) as well as an eligible rollover distribution, you may also designate what part of the nontaxable amount is allocable to the cash distribution and what part is allocable to the property. Your designation must be made by the due date for filing your tax return, including extensions. You cannot change your designation after that date. If you do not make a designation on time, the rollover amount or the nontaxable amount must be allocated on a ratable basis.

Tax-sheltered annuity plan. The preceding rules also apply to distributions from tax-sheltered annuity plans, except that eligible rollover distributions from a tax-sheltered annuity plan cannot be rolled over into a qualified retirement plan. Instead, they can be rolled over into another tax-sheltered annuity plan or into an IRA.

For more information on the tax treatment of distributions from a tax-sheltered annuity plan, get Publication 571.

Section 457 plans. You ***cannot*** roll over any distribution from a section 457 deferred compensation plan of a state or local government or tax-exempt organization.

Qualified domestic relations order. You may be able to roll over tax free all or part of a distribution from a qualified retirement plan that you receive under a qualified domestic relations order. (See *Qualified domestic relations order* under *General Information,* earlier.) If you receive the distribution as an employee's spouse or former spouse (not as a nonspousal beneficiary), the rollover rules apply to you as if you were the employee.

Rollover by surviving spouse. You may be able to roll over tax free all or part of a distribution from a qualified retirement plan you receive as the surviving spouse of a deceased employee. The rollover rules apply to you as if you were the employee, except that you can roll over the distribution only into an IRA. You cannot roll it over into a qualified retirement plan. A distribution paid to a beneficiary other than the employee's surviving spouse is not an eligible rollover distribution.

How to report. On your Form 1040, report the total distribution on line 16a. Report the taxable amount of the distribution minus the amount rolled over, regardless of how the rollover was made, on line 16b. If you file Form 1040A, report the total distribution on line 11a and the taxable amount minus the amount rolled over on line 11b.

Written explanation to recipients. The administrator of a qualified retirement plan must, within a reasonable period of time before making an eligible rollover distribution, provide a written explanation to you. It must tell you about:

1) Your right to have the distribution paid tax free directly to another qualified retirement plan or to an IRA,
2) The requirement to withhold tax from the distribution if it is not paid directly to another qualified retirement plan or to an IRA,
3) The nontaxability of any part of the distribution that you roll over to another qualified retirement plan or to an IRA within 60 days after you receive the distribution, and
4) The other qualified retirement plan rules that apply, including those for lump-sum distributions, alternate payees, and cash or deferred arrangements.

Reasonable period of time. The plan administrator must provide you with a written explanation no earlier than 90 days and no later than 30 days before the distribution is made. However, you can choose to have a distribution made less than 30 days after the explanation is provided as long as the following two requirements are met:

1) You must have the opportunity to consider whether or not you want to make a direct rollover for at least 30 days after the explanation is provided.
2) The information you receive must clearly state that you have the right to have 30 days to make a decision.

Contact the plan administrator if you have any questions regarding this information.

Choosing the right option. The following comparison chart may help you decide which distribution option to choose. Carefully compare the tax effects of each and choose the option that is best for you.

Comparison Chart

Direct Rollover	Payment To You
No withholding.	Payer generally must withhold income tax of 20% on the taxable part even if you roll it over to another plan or to an IRA.
No 10% additional tax.	If you are under age 59½, a 10% additional tax may apply to the taxable part, including the tax withheld, that you do not roll over. See *Tax on Early Distributions,* later.
Not income until later distributed to you from the other plan or the IRA.	Taxable part, including the tax withheld, is income to the extent not rolled over.

Survivors and Beneficiaries

Generally, a survivor or beneficiary reports pension or annuity income in the same way the plan participant reports it. However, some special rules apply, and they are covered elsewhere in this publication as well as in this section.

Estate tax deduction. You may be entitled to a deduction for estate tax if you receive a joint and survivor annuity that was included in the decedent's estate. You can deduct the part of the total estate tax that was based on the annuity, provided that the decedent died after his or her annuity starting date. Deduct it in equal amounts over your remaining life expectancy.

There is a special computation that you must make to figure the estate tax deduction for a surviving annuitant under a joint and survivor annuity. See Income Tax Regulations section 1.691(d)–1.

You can take the estate tax deduction as an itemized deduction on Schedule A, Form 1040. This deduction is not subject to the 2%-of-adjusted-gross-income limit on miscellaneous deductions.

Survivors of employees. Distributions the beneficiary of a deceased employee gets may be accrued salary payments, a distribution from employee profit-sharing, pension, annuity, and stock bonus plans, or other items. Some of these should be treated separately for tax purposes. The treatment of these distributions depends on what they represent.

Salary or wages paid after the death of the employee are usually the beneficiary's ordinary income. If you are a beneficiary of an employee who was covered by any of the retirement plans mentioned, you can exclude from income nonperiodic distributions received that totally relieve the payer from the obligation to pay an annuity. The amount that you can exclude is equal to the deceased employee's contribution to the plan plus the death benefit exclusion, if it applies.

If you are entitled to receive a survivor annuity on the death of an employee, you must report the annuity under the General Rule (see *Partly Taxable Payments,* earlier) or the Simplified General Rule discussed under *Taxation of Periodic Payments,* earlier. In figuring the excludable amount under any of these rules, add any allowable death benefit exclusion (discussed earlier) to your cost.

CAUTION *If you are the beneficiary of an employee who died after August 20, 1996, you are not eligible for the $5,000 death benefit exclusion.*

The beneficiaries are taxed on interest from an employee's death benefit if all or part of the distributable amount is left on deposit under an agreement to pay interest only.

Survivors of retirees. Benefits paid to you as a survivor under a joint and survivor annuity must be included in your gross income. Include them in income in the same way the retiree would have included them in gross income.

If the retiree reported the annuity under the Three-Year Rule and had recovered all of its cost before death, your survivor payments are fully taxable. (But if you received the annuity other than as the survivor under a joint and survivor annuity, see *Death benefit exclusion,* in the discussion of *Investment in the Contract (Cost)* under *Taxation of Periodic Payments,* earlier.)

If the retiree was reporting the annuity under the General Rule, you should apply the same exclusion percentage to your initial survivor annuity payment called for in the contract. The resulting tax-free amount will then remain fixed. Increases in the survivor annuity are fully taxable.

Under the Simplified General Rule, the monthly tax-free amount figured at the annuity starting date applies to both annuitants under a joint and survivor annuity. If the retiree had been reporting the annuity using the Simplified General Rule, you should continue to use the same monthly tax-free amount for your survivor payments.

Guaranteed payments. If you receive guaranteed payments as the decedent's beneficiary under a life annuity contract, do not include any amount in your gross income until your distributions plus the the tax-free distributions received by the life annuitant equal the cost of the contract. All later distributions are fully taxable. This rule does ***not*** apply if it is possible for you to collect more than the guaranteed amount. For example, it does not apply to payments under a joint and survivor annuity.

Special Additional Taxes

To discourage the use of pension funds for purposes other than normal retirement, the law imposes additional taxes on certain distributions of those funds. Ordinarily, you will not be subject to these taxes if you roll over all distributions you receive, as explained earlier, or begin drawing out the funds at a normal retirement age, in reasonable amounts over your life expectancy. The special additional taxes include those on:

- Early distributions.
- Excess distributions.
- Excess Accumulation (not making minimum distributions).

Each of these taxes is discussed in the following sections. If you must pay any of these taxes, report them on Form 5329, *Additional Taxes Attributable to Qualified Retirement Plans (Including IRAs), Annuities, and Modified Endowment Contracts.* However, you do not have to file Form 5329 if you owe only the tax on early distributions and your Form 1099–R shows a "1" in box 7. Instead, enter 10% of the taxable part of the distribution on line 48 of Form 1040 and write "No" on the dotted line next to line 48.

Even if you do not owe any of these taxes, you may have to complete Form 5329 and attach it to your Form 1040. This applies if:

1) You received an early distribution and your Form 1099–R does not show distribution code "2," "3," or "4" in box 7 (or the code number shown is incorrect), or

2) You received distributions that exceed the threshold amount for the tax on excess distributions.

Tax on Early Distributions

Most distributions (both periodic and nonperiodic) from qualified retirement plans and deferred annuity contracts made to you before you reach age 59 1/2 are subject to an additional tax of 10%. This tax applies to the part of the distribution that you must include in gross income.

For this purpose, a qualified retirement plan means:

1) A qualified employee retirement plan (including qualified cash or deferred arrangements (CODAs) under section 401(k)),
2) A qualified annuity plan,
3) A tax-sheltered annuity plan for employees of public schools or tax-exempt organizations, or
4) An individual retirement arrangement (IRA).

Exceptions to tax. The 10% early distribution tax does not apply to distributions that are:

1) Made to a beneficiary or to the estate of the plan participant or annuity holder on or after his or her death,
2) Made because you are totally and permanently disabled,
3) Made as part of a series of substantially equal periodic (at least annual) payments over your life (or life expectancy) or the joint lives (or joint life expectancies) of you and your beneficiary (if from a qualified employee plan, payments must begin after separation from service),
4) Made to you after you separated from service with your employer if the separation occurred during or after the calendar year in which you reached age 55,
5) Paid to you to the extent you have deductible medical expenses (the amount of medical expenses that exceeds 7.5% of your adjusted gross income), whether or not you itemize deductions for the tax year,
6) Paid to alternate payees under qualified domestic relations orders (QDROs),
7) Made to you if, as of March 1, 1986, you separated from service and began receiving benefits from the qualified plan under a written election designating a specific schedule of benefit payments,
8) Made to correct excess deferrals, excess contributions, or excess aggregate contributions,
9) Allocable to investment in a deferred annuity contract before August 14, 1982,
10) From an annuity contract under a qualified personal injury settlement,
11) Made under an immediate annuity contract, or
12) Made under a deferred annuity contract purchased by your employer upon the termination of a qualified employee retirement plan or qualified annuity and that is held by your employer until you separate from the service of the employer.

Only exceptions (1) through (3) apply to distributions from IRAs. Exceptions (4) through (8) apply only to distributions from qualified employee plans. Exceptions (9) through (12) apply only to deferred annuity contracts not purchased by qualified employer plans.

Recapture tax under exception (3). An early distribution recapture tax may apply if, before you reach age 59 1/2, the distribution method under exception (3) changes (for reasons other than your death or disability). The tax applies if the method changes from the method requiring equal payments to a method that would not have qualified for the exception to the tax. The recapture tax applies to the first tax year to which the change applies. The amount of tax is the amount that would have been imposed had the exception not applied, plus interest for the deferral period.

The recapture tax also applies if you do not receive the payments for at least 5 years under a method that qualifies for the exception. It applies even if you modify your method of distribution after you reach age 59 1/2. In that case, the tax applies only to payments distributed before you reach age 59 1/2.

5% rate on certain early distributions from deferred annuity contracts. If an early withdrawal from a deferred annuity is otherwise subject to the 10% tax, a 5% rate may apply instead. A 5% rate applies if, as of March 1, 1986, you were receiving payments under a written election providing a specific schedule for the distribution of your interest in the contract. On line 4 of Form 5329, multiply by 5% instead of 10%. Attach an explanation to your return.

Tax on Excess Distributions

If you received retirement distributions in excess of $155,000 during the calendar year, you are subject to an additional 15% excise tax on the amount over $155,000. The 15% tax is offset by any 10% early distribution tax that applies to the excess distribution. (See the preceding discussion.)

Retirement distributions are distributions from qualified employee retirement plans, qualified annuity plans, tax-sheltered annuities, and individual retirement arrangements (IRAs). They include the net unrealized appreciation (NUA) in employer securities. For information on the regular tax treatment of NUA, see *Distributions of employer securities,* under *Lump-sum distributions,* earlier.

Exceptions to tax for 1996. The 15% tax on excess distributions does not apply to the following distributions in 1996:

1) Distributions after the death of the participant (but see *Increase in estate tax,* later),
2) Distributions paid to your spouse or former spouse under a qualified domestic relations order (QDRO) that are not included in your gross income (the distributions are included in determining your spouse's or former spouse's excess distributions),
3) Distributions based on the participant's investment in the contract,
4) Distributions to the extent rolled over tax free,
5) Distributions of annuity contracts, the value of which are not included in gross income at the time of the distribution (other than distributions under, or proceeds from the sale or exchange of, such contracts),
6) Distributions of excess deferrals (and income allocable to them) as discussed under *Excess Contributions, Deferrals, and Annual Additions,* earlier, and
7) Distributions of excess contributions (and income allocable to them) under section 401(k) plans or IRAs, or excess aggregate contributions (and income on them) under qualified plans.

TIP *You will not be subject to this additional 15% tax if you receive the retirement distributions after December 31, 1996 (and before the year 2000).*

Combining distributions. If distributions for you are made to you and others, you must combine the distributions in figuring the amount of excess distributions for the year.

Lump-sum distributions. A special dollar limit applies to a lump-sum distribution if you choose the 5– or 10–year tax option and/or capital gain treatment. The threshold amount of $155,000 increases five times to $775,000 for lump-sum distributions. You must figure a separate tax on the lump-sum distribution over $775,000.

Special grandfather election. If you made a special "grandfather election" on your 1987 or 1988 return, you must use a different rule to figure the excess distributions tax. Under that rule, exclude from the amount subject to the tax the part of your distribution that is treated as being from your accrued benefits as of August 1, 1986. To have qualified for this special choice, your accrued benefits on August 1, 1986, must have been more than $562,500.

If you made this choice, the excess distributions tax applies to your retirement distributions for 1996 that is more than the greater of:

1) The part of your distributions treated as being from your accrued benefits on August 1, 1986 (your recovered grandfather amount), or
2) $155,000 ($775,000 if a lump-sum distribution).

For details, see Form 5329 and its instructions.

Increase in estate tax. The federal estate tax on the estate of a decedent is increased by 15% of the decedent's excess retirement accumulation. Credits against the estate tax, such as the unified credit, do not offset this additional tax. Figure the excess retirement accumulation, if any, as follows. Add the total value (as included in the gross estate) of the decedent's interests in all qualified employee plans, qualified annuity plans, tax-sheltered annuities, and individual retirement arrangements. Subtract from this the "present value" of a hypothetical single life annuity. This annuity would be for a period equal to the decedent's life expectancy immediately before death, with annual payments of $155,000. (If the decedent had made the special grandfather election, subtract instead the greater of any unrecovered grandfather amount or the hypothetical life annuity figured with annual payments (for a decedent dying in 1996) of $155,000.)

See the instructions for Schedule S of Form 706, *United States Estate (and Generation-Skipping Transfer) Tax Return,* for more information.

Special choice by spouse. The decedent's spouse may be able to choose not to have the increase in estate tax apply. The spouse can make this choice if he or she is the beneficiary of all (or all except for a *de minimis* portion) of the decedent's interests in the plans listed earlier. If the spouse makes this choice, the tax on excess distributions will apply to the spouse. Any retirement distributions from the decedent's interests in the retirement plans will be treated as if the interests were the spouse's.

Tax on Excess Accumulation

To make sure that most of your retirement benefits are paid to you during your lifetime, rather than to your beneficiaries after your death, your retirement payments from qualified plans and IRAs must generally begin, at the latest, soon after you reach age 70 ½. The payments cannot be less than the minimum distribution required each year. If the actual distributions to you in any year are less than the minimum required for that year, you are subject to an additional tax. The tax equals 50% of the required minimum amount not distributed. The rules on when minimum distributions must begin and how they are figured are described below.

TIP *Beginning in 1997, this rule will take into account whether you have retired.*

The additional tax applies to qualified employee retirement plans, qualified annuity plans, deferred compensation plans under section 457, tax-sheltered annuity programs (for benefits accruing after 1986), and IRAs.

The tax may be waived if you establish that the shortfall in distributions was due to reasonable error and that reasonable steps are being taken to remedy the shortfall.

State insurer delinquency proceedings. You might not receive the minimum distribution because of state insurer delinquency proceedings for an insurance company. If your payments are reduced below the minimum because of these proceedings, you should contact your plan administrator. Under certain conditions, you will not have to pay the excise tax.

Required beginning date. For years beginning before 1997, you must begin receiving distributions from your retirement plan by April 1 of the year following the calendar year in which you reached age 70 ½. This applies whether or not you have actually retired. You would be subject to the tax on excess accumulations if you reached age 70 ½ during 1995 and did not receive the required minimum distribution by April 1, 1996. You would owe the tax on your 1996 return.

You reach age 70½ on the date that is 6 calendar months after the date of your 70th birthday. For example, if your 70th birthday was on July 1, 1995, you were age 70 ½ on January 1, 1996. Your required beginning date for receiving distribution is April 1, 1997. If your 70th birthday was on June 30, 1995, you were age 70 ½ on December 30, 1995, and your required beginning date is April 1, 1996.

Exceptions. In some cases, you do not have to begin receiving benefits from an employee plan until April 1 of the year following the calendar year in which you retire. This applies regardless of your age, if you either:

1) Are covered by a government or church plan and have reached age 70 ½ before the year in which you retire, or

2) Reached age 70½ before 1988 and were not a 5% owner.

You do not meet the requirement in (2) if, at any time during the 5-plan-year period ending in the calendar year in which you reached age 70 ½ or during any later plan year, you owned or were considered to own more than 5% of the outstanding stock (or more than 5% of the total voting power of all stock) of the employer, or more than 5% of the capital or profits interest in the employer.

If neither exception applies, you are subject to the tax for 1996 if you retired or became a 5% owner in 1995 and did not receive the required minimum distribution from your qualified employee retirement plan by April 1, 1996.

TIP *Starting in 1997, the required beginning date for receiving distributions, if you are still working at age 70 ½, is April 1 of the year following the calendar year in which you retire. This does not apply to IRAs.*

Exception. A 5% owner must still begin to receive distributions on April 1 of the year following the calendar year in which he or she reaches age 70 ½.

Required distributions. You must either:

1) Receive your entire interest in the plan (for a tax-sheltered annuity, your entire benefit accruing after 1986) by the required beginning date, as explained above, or

2) Begin receiving periodic distributions by that date in annual amounts calculated to distribute your entire interest (for a tax-sheltered annuity, your entire benefit accruing after 1986) over your life or life expectancy or over the joint lives or joint life expectancies of you and your designated beneficiary (or over a shorter period).

The term ''designated beneficiary'' as used here means the individual who is your beneficiary under your retirement plan or annuity upon your death. If you have more than one beneficiary, the beneficiary with the shortest life expectancy, usually the oldest individual, will be the ''designated beneficiary.''

After the starting year for periodic distributions, you must receive the required distribution for each year by December 31 of that year. (The starting year is the year in which you reach age 70 ½ or retire, whichever applies in determining your required beginning date.) If no distribution is made in your starting year, the required distributions for 2 years are required the following year (one by April 1 and one by December 31).

Example. You retired in 1995. You reached age 70½ on August 20, 1996. For 1996 (your starting year), you must receive a minimum amount from your retirement plan by April 1, 1997. You must receive the minimum required distribution for 1997 by December 31, 1997.

Distributions after the employee's death. If the employee was receiving periodic distributions before his or her death, any payments not made as of the time of death must be distributed at least as rapidly as under the distribution method being used at the date of death.

If the ***employee dies before the required beginning date,*** the entire account must be distributed either:

Rule 1. By December 31 of the fifth year following the year of the employee's death, or

Rule 2. In annual amounts over the life or life expectancy of the designated beneficiary.

Which of these two rules applies depends on the terms of the plan. The terms of the plan may permit the employee or the beneficiary to choose the rule that applies. This choice must be made by the earliest date a distribution would be required under either of the rules. Generally, this date is December 31 of the year following the year of the employee's death.

If the employee or the beneficiary did not choose either rule and the plan does not specify the one that applies, distribution must be made under rule 2 if the beneficiary is the surviving spouse and under rule 1 if the beneficiary is someone other than the surviving spouse. Distributions under rule 2 generally must begin by December 31 of the year following the year of the employee's death. However, if the spouse is the beneficiary, distributions need not begin until December 31 of the year the employee would have reached age 70 $1/2$, if later.

If a spouse is the designated beneficiary and distributions are to be made under rule 2, a special rule applies if the spouse dies after the employee but before distributions are required to begin. In this case, distributions may be made to the spouse's beneficiary under either rule 1 or rule 2, as though the beneficiary were the employee's beneficiary and the employee died on the spouse's date of death. However, if the spouse remarries after the employee's death and the new spouse is designated as the spouse's beneficiary, this special rule applicable to surviving spouses does not apply to the new spouse.

Minimum distributions from annuity plan. Special rules apply if you receive distributions from your retirement plan in the form of an annuity. Your plan administrator should be able to give you information about these rules.

Minimum distributions from an individual account plan. If there is an ***account balance*** to be distributed from your plan (not as an annuity), your plan administrator must figure the minimum amount that must be distributed from the plan each year. For distributions being made over life expectancy, this amount is figured by dividing the account balance at the end of the preceding year by an ***applicable life expectancy*** (from tables published by the IRS). The applicable life expectancy is:

1) The life expectancy of the employee, or the joint life and last survivor expectancy of the employee and the designated beneficiary, if distributions begin by the employee's required beginning date, or
2) The life expectancy of the designated beneficiary if the employee dies before the required beginning date.

Account balance. Use the value of the account balance at the end of the preceding year (valuation calendar year), adjusted as follows:

1) Add the amount of any contributions made for the valuation calendar year, including those made after the close of the valuation date (up to the filing due date (plus extensions) of the individual income tax return of the plan participant).
2) Subtract distributions made in the valuation calendar year after the valuation date.

What types of installments are allowed? The minimum amount that must be distributed for any year may be made in a series of installments (e.g., monthly, quarterly, etc.) as long as the total payments for the year made by the date required are not less than the minimum amount required.

More than minimum. Your plan can distribute more in any year than the minimum amount required for that year, but if it does, you will not receive credit for the additional amount in determining the minimum amount required for future years. However, any amount distributed in your starting year will be credited toward the amount required to be distributed by April 1 of the following year.

Life expectancy. For distributions beginning during your life that are made by April 1 after your starting year, the initial life expectancy (or joint life and last survivor expectancy) is determined using the ages of you and your designated beneficiary as of your birthdays in your starting year.

For distributions beginning after the employee's death (if death occurred before April 1 following the employee's starting year) over the life expectancy of the designated beneficiary, the initial life expectancy of the designated beneficiary is determined using the beneficiary's age as of his or her birthday in the year distributions must begin.

Unless your plan provides otherwise, your life expectancy (and that of your spouse, if it applies) must be redetermined annually. (The life expectancy of a designated beneficiary who is someone other than your spouse cannot be redetermined.) If life expectancy is not redetermined, the initial life expectancy is simply reduced by one for each year after your starting year to determine the remaining life expectancy.

If the life expectancies of both the employee and the employee's spouse are redetermined, and either one dies, use only the survivor's life expectancy to figure distributions in years following the year of death. If both the employee and his or her spouse die, the entire remaining interest must be distributed by the end of the year following the year of the second death.

If the life expectancy of only one individual (either the employee or the employee's spouse) is redetermined and that individual dies, use only the other individual's life expectancy to figure distributions in years following the year of death. If, instead, the other individual dies, his or her life expectancy as if the death had not occurred continues to be used to figure the remaining distributions. These rules also apply if the designated beneficiary is someone other than the employee's spouse.

Your plan may also permit you and your spouse to choose whether or not your life expectancies are to be redetermined. This choice must be made by the date the first distribution is required to be made from the plan.

Minimum distribution incidental benefit requirement. Distributions from a retirement plan during the employee's lifetime must satisfy, in addition to the above requirements, the ***minimum distribution incidental benefit (MDIB) requirement.*** This requirement is to ensure that the plan is used primarily to provide retirement benefits to the employee. After the employee's death, only ''incidental'' benefits are expected to remain for distribution to the employee's beneficiary (or beneficiaries).

If your spouse is your only beneficiary, the MDIB requirement is satisfied if the general minimum distribution requirements discussed above are satisfied. If your spouse is not your only beneficiary, your plan administrator must figure your required minimum distribution by dividing the account balance at the end of the year by the ***smaller*** of the applicable life expectancy or the MDIB divisor that applies (from a table published by the IRS).

Combining multiple annuity accounts for satisfying the minimum distribution requirements. The required minimum distribution must be figured separately for each account. Each qualified employee retirement plan and qualified annuity plan must be considered individually in satisfying its distribution requirements. However, if you have more than one tax-sheltered annuity account or more than one individual retirement arrangement (IRA), you can total the required distributions and then satisfy the requirement by taking distributions from any one (or more) of the tax-sheltered annuities or IRAs, respectively. Distributions from tax-sheltered annuities will not satisfy the distribution requirements for IRAs, nor will distributions from IRAs satisfy the requirements for tax-sheltered annuity distributions.

How To Get More Information

You can get help from the IRS in several ways.

Free publications and forms. To order free publications and forms, call 1–800–TAX–FORM (1–800–829–3676). You can also write to the IRS Forms Distribution Center nearest you. Check your income tax package for the address. Your local library or post office also may have the items you need.

For a list of free tax publications, order Publication 910, *Guide to Free Tax Services.* It also contains an index of tax topics and related publications and describes other free tax information services available from IRS, including tax education and assistance programs.

If you have access to a personal computer and modem, you also can get many forms and publications electronically. See *Quick and Easy Access to Tax Help and Forms* in your income tax package for details. If space permitted, this information is at the end of this publication.

Tax questions. You can call the IRS with your tax questions. Check your income tax package or telephone book for the local number, or you can call 1–800–829–1040. You can also get help from the employee plans taxpayer assistance telephone service. For the hours of operation, see *Introduction,* earlier.

TTY/TDD equipment. If you have access to TTY/TDD equipment, you can call 1–800–829–4059 with your tax questions or to order forms and publications. See your income tax package for the hours of operation.

Table 1. **Worksheet A–1 Simplified General Rule** (Keep for Your Records)

For annuity starting dates before Nov. 19, 1996.

1.	Total pension received this year. Also, add this amount to the total for Form 1040, line 16a, or Form 1040A, line 11a	$________
2.	Your cost in the plan (contract) at annuity starting date, plus any death benefit exclusion (if it applies)	________
3.	Age at annuity starting date: / If **before** Nov. 19, 1996, enter: 55 and under — 300 56–60 — 260 61–65 — 240 66–70 — 170 71 and over — 120	________
4.	Divide line 2 by line 3	________
5.	Multiply line 4 by the number of months for which this year's payments were made	________
	NOTE: If your annuity starting date is **after Nov. 18, 1996,** use Worksheet B on the next page. If your annuity starting date is **before 1987,** enter the amount from line 5 on line 8 below. Skip lines 6, 7, 10, and 11.	
6.	Any amounts previously recovered tax free in years after 1986........	________
7.	Subtract line 6 from line 2	________
8.	Enter the lesser of line 5 or line 7	________
9.	**Taxable pension for year.** Subtract line 8 from line 1. Enter the result, but not less than zero. Also add this amount to the total for Form 1040, line 16b, or Form 1040A, line 11b . . .	$________
	NOTE: If your Form 1099-R shows a larger taxable amount, use the amount on line 9 instead.	
10.	Add lines 6 and 8	________
11.	Balance of cost to be recovered. Subtract line 10 from line 2	$________

Table 2. **Worksheet B–1 Simplified General Rule** (Keep for Your Records)

For annuity starting dates after Nov. 18, 1996.

1. Total pension received this year. Also, add this amount to the total for Form 1040, line 16a, or Form 1040A, line 11a .... $______

2. Your cost in the plan (contract) at annuity starting date .... ______

3.

Age at annuity starting date:	If **after** Nov. 18, 1996, enter:
55 and under	360
56–60	310
61–65	260
66–70	210
71 and over	160 .... ______

4. Divide line 2 by line 3 .... ______

5. Multiply line 4 by the number of months for which this year's payments were made .... ______

   NOTE: If your annuity starting date is **before Nov. 19, 1996,** use Worksheet A on the preceding page. If your annuity starting date is **before 1987,** enter the amount from line 5 on line 8 below. Skip lines 6, 7, 10, and 11.

6. Any amounts previously recovered tax free in years after 1986 .... ______

7. Subtract line 6 from line 2 .... ______

8. Enter the lesser of line 5 or line 7 .... ______

9. **Taxable pension for year.** Subtract line 8 from line 1. Enter the result, but not less than zero. Also add this amount to the total for Form 1040, line 16b, or Form 1040A, line 11b . . . $______

   NOTE: If your Form 1099-R shows a larger taxable amount, use the amount on line 9 instead.

10. Add lines 6 and 8 .... ______

11. Balance of cost to be recovered. Subtract line 10 from line 2 .... $______