

of lesser or greater severity, must be evaluated in terms of whether it does in fact prevent the individual from engaging in his customary or any comparable substantial gainful activity.

(3) In order to meet the requirements of section 72(m)(7), an impairment must be expected either to continue for a long and indefinite period or to result in death. Ordinarily, a terminal illness because of disease or injury would result in disability. Indefinite is used in the sense that it cannot reasonably be anticipated that the impairment will, in the foreseeable future, be so diminished as no longer to prevent substantial gainful activity. For example, an individual who suffers a bone fracture which prevents him from working for an extended period of time will not be considered disabled, if his recovery can be expected in the foreseeable future; if the fracture persistently fails to knit, the individual would ordinarily be considered disabled.

(4) An impairment which is remediable does not constitute a disability within the meaning of section 72(m)(7). An individual will not be deemed disabled if, with reasonable effort and safety to himself, the impairment can be diminished to the extent that the individual will not be prevented by the impairment from engaging in his customary or any comparable substantial gainful activity.

(g) *Years to which this section applies.* This section applies to taxable years ending before September 3, 1974. For taxable years ending after September 2, 1974, see § 1.72-17A.

[T.D. 6676, 28 FR 10136, Sept. 17, 1963, as amended by T.D. 6885, 31 FR 7800, June 2, 1966; T.D. 6985, 33 FR 19811, Dec. 27, 1968; T.D. 7114, 36 FR 9018, May 18, 1971; T.D. 7636, 44 FR 47049, Aug. 10, 1979]

**§ 1.72-17A Special rules applicable to employee annuities and distributions under deferred compensation plans to self-employed individuals and owner-employees.**

(a) *In general.* Section 72(m) and this section contain special rules for the taxation of amounts received from qualified pension, profit-sharing, or annuity plans covering an owner-employee. This section applies to such amounts for taxable years of the recipient ending after September 2, 1974, un-

less another date is specified. For purposes of this section, the term "employee" shall include the self-employed individual who is treated as an employee by section 401(c)(1), and the term "owner-employee" has the meaning assigned to it in section 401(c)(3). Paragraph (b) of this section provides rules dealing with the computation of consideration paid by self-employed individuals and paragraph (c) of this section provides rules dealing with such computation when insurance is purchased for owner-employees. Paragraph (d) of this section provides rules for constructive receipt and, for purposes of these rules, treats as an owner-employee an individual for whose benefit an individual retirement account or annuity described in section 408 (a) or (b) is maintained after December 31, 1974. Paragraph (e) of this section provides rules for penalties provided by section 72(m)(5) with respect to certain distributions received by owner-employees or their successors. Paragraph (f) of this section provides rules for determining whether a person is disabled within the meaning of section 72(m)(7). See § 1.72-16, relating to life insurance contracts purchased under qualified employee plans, for rules under section 72(m)(3).

(b) *Computation of consideration paid by self-employed individuals.* Under section 72(m)(2), consideration paid or contributed for the contract by any self-employed individual shall for purposes of section 72 be deemed not to include any contributions paid or contributed under a plan described in paragraph (a), or any other plan of deferred compensation described in section 404(a) (whether or not qualified), if the contributions are—

(1) Paid under such plan with respect to a time during which the employee was an employee only by reason of sections 401(c)(1) and 404(a)(8), and

(2) Deductible under section 404 by the employer, including an employer within the meaning of sections 401(c)(4) and 404(a)(8), of such self-employed individual at the time of such payment, or subsequent to such time of payment. For purposes of this paragraph the term "consideration paid or contributed for the contract" has the same meaning as under subparagraphs (1),

(2), and (3) of paragraph (c) of this section.

(c) *Amounts paid for life, accident, health, or other insurance.* Under section 72(m)(2), amounts used to purchase life, accident, health, or other insurance protection for an owner-employee shall not be taken into account in computing the following:

(1) The aggregate amount of premiums or other consideration paid for the contract for purposes of determining the investment in the contract under section 72(c)(1)(A) and § 1.72-6;

(2) The consideration for the contract contributed by the employee for purposes of section 72(d)(1) and § 1.72-13, which provide the method of taxing employee's annuities where the employee's contributions will be recoverable within 3 years; and

(3) The aggregate premiums or other consideration paid for purposes of section 72(e)(1)(B) and § 1.72-11, which provide the rules for taxing amounts not received as annuities prior to the annuity starting date.

The cost of such insurance protection will be considered to be a reasonable net premium cost, as determined by the Commissioner, for the appropriate period.

(d) *Amounts constructively received.* (1) The references in this paragraph (d) to section 72(m)(4) are to that section as in effect on August 13, 1982. Section 236(b)(1) of the Tax Equity and Fiscal Responsibility Act of 1982 (96 Stat. 324) repealed section 72(m)(4), generally effective for assignments, pledges and loans made after August 13, 1982, and added section 72(p). See section 72(p) and § 1.72(p)-1 for rules governing the income tax treatment of certain assignments, pledges and loans from qualified employer plans made after August 13, 1982.

(2) Under section 72(m)(4)(A), if during any taxable year an owner-employee assigns or pledges (or agrees to assign or pledge) any portion of his interest in a trust described in section 401(a) which is exempt from tax under section 501(a), or any portion of the value of a contract purchased as part of a plan described in section 403(a), such portion shall be treated as having been received by such owner-employee as a distribution from the trust or as an

amount received under the contract during such taxable year.

(3)(i) Under paragraphs (4)(A) and (6) of section 72(m), if after December 31, 1974, during any taxable year an individual for whose benefit an individual retirement account or annuity described in section 408 (a) or (b) is maintained assigns or pledges (or agrees to assign or pledge) any portion of his interest in such account or annuity, such portion shall be treated as having been received by such individual as a distribution from such account or trust during such taxable year. See subsections (d) and (f) of section 408 and the regulations thereunder for the tax treatment of an amount treated as a distribution under this subparagraph.

(ii) Notwithstanding subdivision (i) of this subparagraph, if an individual retirement account or annuity, or portion thereof, is subject to the additional tax imposed by section 408(f), that amount shall be deemed not to be a distribution under section 72(m)(4)(A) and subdivision (i) of this subparagraph.

(4) Under section 72(m)(4)(B), if during any taxable year an owner-employee receives, either directly or indirectly, any amount from any insurance company as a loan under a contract purchased by a trust described in section 401(a) which is exempt from tax under section 501(a) or purchased as part of a plan described in section 403(a), and issued by such insurance company, such amount shall be treated as an amount received under the contract during such taxable year. An owner-employee will be considered to have received an amount under a contract if a premium, which is otherwise in default, is paid by the insurance company in the form of a loan against the cash surrender value of the contract. Further, an owner-employee will be considered to have received an amount to which this subparagraph applies if an amount is received from the issuer of a face-amount certificate as a loan under such a certificate purchased as part of a qualified trust or plan.

(e) *Penalties applicable to certain amounts received with respect to owner-employees under section 72(m)(5).* (1)(i) For taxable years of the recipient beginning after December 31, 1975, if any

person receives an amount to which subparagraph (2) of this paragraph applies, his tax under Chapter 1 for the taxable year in which such amount is received shall be increased by an amount equal to 10 percent of the portion of the amount so received which is includible in his gross income for such taxable year.

(ii) For taxable years of the recipient beginning before January 1, 1976, see subparagraph (3) of this paragraph.

(2)(i) This subparagraph is applicable to amounts, to the extent includible in gross income, received from a qualified trust described in section 401(a) or under a plan described in section 403(a) by or on behalf of an individual who is or has been an owner-employee with respect to such trust or plan—

(A) Which are received before the owner-employee reaches the age of 59½ years, and which are attributable to contributions paid on behalf of such owner-employee by his employer (that is employer contributions within the meaning of section 401(c)(5)(A) and the increments in value attributable to such employer contributions) and the increments in value attributable to contributions made by him as an owner-employee while he was an owner-employee (that is, the increments attributable to owner-employee contributions within the meaning of section 401(c)(5)(B), but not such contributions; see subdivision (ii) of this subparagraph).

(B) Which are in excess of the benefits provided for such owner-employee under the plan formula (see subdivision (iii) of this subparagraph), or

(C) Which are subject to the transitional rules with respect to willful excess contributions made on behalf of an owner-employee in his employer's taxable years which begin before January 1, 1976 (see subdivision (v) of this subparagraph).

(ii) The amounts referred to in subdivision (i)(A) of this subparagraph do not include—

(A) Amounts received by reason of the owner-employee becoming disabled (see paragraph (f) of this section).

(B) Amounts received by the owner-employee in his capacity as a policyholder of an annuity, endowment, or life insurance contract which are in the

nature of a dividend or similar distribution, or

(C) Amounts attributable to contributions (and increments in value thereon) made for years for which the recipient was not an owner-employee.

If an amount is not included in the amounts referred to in subdivision (i)(A) of this subparagraph solely by reason of the owner-employee's becoming disabled and if a penalty would otherwise be applicable with respect to all or a portion of such amount, then for the owner-employee's taxable year in which such amount is received, there must be submitted with his income tax return a doctor's statement as to the impairment, and a statement by the owner-employee with respect to the effect of such impairment upon his substantial gainful activity and the date such impairment occurred. For taxable years which are subsequent to the first taxable year with respect to which the statements referred to in the preceding sentence are submitted, the owner-employee may, in lieu of such statements, submit a statement declaring the continued existence (without substantial diminution) of the impairment and its continued effect upon his substantial gainful activity.

(iii) This subparagraph applies to amounts described in subdivision (i)(B) of this subparagraph (relating to benefits in excess of the plan formula) even though a portion of such amounts may be attributable to contributions made on behalf of an individual while he was not an owner-employee and even if he is deceased and the amounts are received by his successor.

(iv)(A) The rules described in subdivisions (i)(A) and (iii) of this subparagraph, relating to the treatment under section 72(m)(5)(A)(i) of certain premature distributions, may be illustrated by the following example:

*Example.* (1) A was a member of the X partnership, consisting of partners A through I, and a participant in the partnership's qualified profit-sharing plan which was established on January 1, 1972. A's taxable years, the X partnership's taxable years, the plan years, and other relevant years are all calendar years at all relevant times. For the three calendar years, 1972 through 1974, A was an owner-employee in the X partnership. On January 1, 1975, new partners J and K became partners in the X partnership, and as of

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that date, each of partners A through K held a 1/11 interest in the capital and profits of the X partnership. On that date, A became a partner who was not an owner-employee. A continued in this status for the 2 calendar years 1975 and 1976. On January 1, 1977, when A was 50 years old and not disabled, he liquidated his interest in the X partnership and became an employee of an unrelated em-

ployer. On that date, A received a distribution representing his entire interest in the X partnership's plan of \$54,000 cash in violation of the plan provision required by section 401(d)(4)(B). As of that date, the distribution was attributable to the following sources and times, computed by the plan in a manner consistent with the subparagraph:

Calendar years	A	B	C	D
	X contributions on behalf of A deductible under sec. 404	A's contributions made as an employee	Increments in value attributable to column A yearly contributions	Increments in value attributable to column B yearly contributions
1977 .....	0	0	0	0
1976 .....	\$7,500	\$2,500	\$900	\$300
1975 .....	7,500	2,500	4,000	1,300
1974 .....	7,500	2,500	1,800	700
1973 .....	2,500	2,500	1,200	1,200
1972 .....	2,500	2,500	1,300	1,300
Totals .....	27,500	12,500	9,200	4,800

(2) The amount of the \$54,000 distribution to which subdivision (i)(A) of this subparagraph applies is \$20,000, computed as follows:

X contributions on behalf of A made in years A was an owner-employee:	
1974 .....	\$7,500
1973 .....	2,500
1972 .....	2,500
Total .....	12,500
Increments in value attributable to such contributions:	
1974 .....	1,800
1973 .....	1,200
1972 .....	1,300
Total .....	4,300
Increments in value attributable to contributions made by A as an employee for years in which he was an owner-employee:	
1974 .....	700
1973 .....	1,200
1972 .....	1,300
Total .....	3,200
Grand total .....	20,000

In this example, the \$20,000 amount computed above would be includible in A's gross income for 1977 and would be subject to the 10 percent tax described in subparagraph (1)(i) of this paragraph.

(3) Subdivision (i)(A) of this subparagraph does not apply to the contributions made by X on behalf of A for 1976 and 1975 (\$7,500 each year, totaling \$15,000) nor to the increments in value attributable to those contributions (\$900 for 1976 and \$4,000 for 1975, totaling

\$4,900), because A was not an owner-employee with respect to these two years, 1976 and 1975, on account of which these employer contributions were made. For the same reason, subdivision (i)(A) of this subparagraph does not apply to the increments in value attributable to A's contributions for 1976 and 1975 (\$300 and \$1,300, respectively, totaling \$1,600).

See section 4972(c) for the amount of employee contributions which is permitted to be contributed by an owner-employee (as an employee) without subjecting an owner-employee to the tax on excess contributions.

(4) Subdivision (i)(A) of this subparagraph does not apply to the contributions made by A, as an employee during the years when he was an owner-employee (\$2,500 during each of the years 1972, 1973, and 1974, totaling \$7,500), because the distribution was received in a taxable year of A ending after September 2, 1974; see subparagraph (3) of this paragraph. Furthermore, because the distribution of the amount of A's contributions (\$12,500) constitutes consideration for the contract paid by A for purposes of section 72, the \$7,500 amount described in the preceding sentence is not includible in his gross income, and that amount is not subject to the rules of this subparagraph; see subdivision (i) of this subparagraph, and paragraphs (b) and (c) of this section.

(B) The increments in value of an individual's account may be allocated to contributions on his behalf, by his employer or by such individual as an owner-employee, while he was an owner-employee either by maintaining a separate account, or an accounting,

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which reflects the actual increment attributable to such contributions, or by the method described in (C) of this subdivision.

(C) Where an individual is covered under the same plan both as an owner-employee and as a non-owner-employee, the portion of the increment in value of his interest attributable to contributions made on his behalf while he was an owner-employee may be determined by multiplying the total increment in value in his account by a fraction. The numerator of the fraction is the total contributions made on behalf of the individual as an owner-employee, weighted for the number of years that each contribution was in the plan. The denominator is the total contributions made on behalf of the individual, whether or not as an owner-employee, weighted for the number of years each contribution was in the plan. The contributions are weighted for the number of years in the plan by multiplying each contribution by the number of years it was in the plan. For purposes of this computation, any forfeiture allocated to the account of the individual is treated as a contribution to the account made at the time so allocated. For purposes of this computation, where the individual has received a prior distribution from such account, an appropriate adjustment must be made to reflect such prior distribution.

(D) The method described in (C) of this subdivision may be illustrated by the following example:

*Example.* B was a member of the XYZ Partnership and a participant in the partnership's profit-sharing plan which was created in 1973. Until the end of 1977, B's interest in the partnership was less than 10 percent. On January 1, 1978, B obtained an interest in excess of 10 percent in the partnership and continued to participate in the profit-sharing plan until 1982. During 1982, prior to the time he attained the age of 59½ years and during a time when he was not disabled, B, who had not received any prior plan distributions, withdrew his entire interest in the profit-sharing plan. At the time his interest was \$15,000, \$9,600 contributions and \$5,400 increment attributable to the contributions. The portion of the increment attributable to contributions while B was an owner-employee is \$667.80, determined as follows:

	A	B	C
	Contribution	Number of years contribution was in trust	Contribution weighted for years in trust (AxB)
1982 .....	\$1,000	0	0
1981 .....	800	1	800
1980 .....	1,200	2	2,400
1979 .....	600	3	1,800
1978 .....	200	4	800
1977 .....	400	5	2,000
1976 .....	2,000	6	12,000
1975 .....	1,000	7	7,000
1974 .....	1,500	8	12,000
1973 .....	900	9	8,100
Total .....	9,600	.....	46,900

Total weighted contributions as owner-employee (1978-1982)=\$5,800.

Total weighted contributions=\$46,900.

$$\$5,400 \times (5,800 \div 46,900) = \$667.80$$

(E)(1) The rules set forth in subdivision (iv)(E)(2) of this subparagraph shall be used to determine the amounts to which subdivision (i)(A) of this subparagraph applies in the case of a distribution of less than the entire balance of the employee's account from a plan in which he has been covered at different times as owner-employee or as an employee other than an owner-employee.

(2) Distributions or payments from a plan for any employee taxable year shall be deemed to be attributable to contributions to the plan, and increments thereon, in the following order—

(i) Excess contributions, within the meaning of section 4972 (b), designated as such by the trustee;

(ii) Employee contributions;

(iii) Employer contributions, other than those described in (i), and the increments in value attributable to the employee's own contributions and his employer's contributions on the basis of the taxable years of his employer in succeeding order of time whether or not the employee was an owner-employee for any such year.

For purposes of (iii) of this subdivision, the time of contributions made on the basis of any employer taxable year shall take into account the rule specified in section 404(a)(6), relating to time when contributions deemed made.

(v) The amounts referred to in subdivision (i)(C) of this subparagraph are amounts which are received by reason

of a distribution of the owner-employee's entire interest under the provisions of section 401(e)(2)(E), as in effect on September 1, 1974, relating to excess contributions on behalf of an owner-employee which are willfully made. Notwithstanding the preceding sentence, an owner-employee's entire interest in all plans with respect to which he is an owner-employee (within the meaning of subsections (d)(8)(C) and (e)(2)(E)(ii) of section 401, as in effect on September 1, 1974) does not include any distribution or payment attributable to his employer's contributions or his own contributions made with respect to his employer's taxable years beginning after December 31, 1975. However, his entire interest in all plans does include all of the distribution or payment attributable to his employer's contributions and his own contributions made with respect to all of his employer's taxable years beginning before January 1, 1976, if any portion thereof is attributable in whole or in part to such a willful excess contribution and such entire interest is received because of a willful excess contribution pursuant to section 401(e)(2)(E)(ii). A distribution or payment is described in the preceding sentence even though it is received in an owner-employee's taxable year beginning after December 31, 1975. For purposes of computing the increments in value attributable to employer taxable years which begin before January 1, 1976, and such increments attributable to such years beginning after December 31, 1975, the rules specified in subdivision (iv)(B), (C), (D), and (E) of this subparagraph shall be applied to the extent applicable. See § 1.401(e)-4(c) for transitional rules with respect to contributions described in this subdivision.

(3)(i) For taxable years of the recipient beginning before January 1, 1976, the tax with respect to amounts to which subparagraph (2) of this paragraph applies shall be computed under subparagraphs (B), (C), (D), and (E) of section 72(m)(5) as such subparagraphs were in effect prior to the amendments made by subsections (g)(1) and (2)(A) of section 2001 of the Employee Retirement Income Security Act of 1974 (88 Stat. 957) except as provided in subdivi-

sions (ii) and (iii) of this subparagraph (see paragraph (e) of § 1.72-17). For purposes of the preceding sentence, amounts to which subparagraph (2) of this paragraph applies in the case of an amount described in section 72(m)(5)(A)(i) shall be determined under subdivisions (i)(a) and (ii) of § 1.72-17(e)(1), except as provided in subdivision (ii) of this subparagraph. For purposes of the first sentence of this subdivision, amounts to which subparagraph (2) of this paragraph applies in the case of an amount described in section 72(m)(5)(A)(ii) shall be determined under subdivisions (i)(b) and (iii) of § 1.72-17(e)(1), except as provided in subdivision (iii) of this subparagraph.

(ii) For purposes of applying section 72(m)(5)(A)(i), after the amendment made by section 2001(h)(3) of such Act, and subdivisions (i)(a) and (ii) of § 1.72-17(e)(1), to a distribution or payment received in recipient taxable years ending after September 2, 1974, and beginning before January 1, 1976, with respect to contributions made on behalf of an owner-employee which were made by him as an owner-employee (that is, employee contributions within the meaning of section 401(c)(5)(B)) the portion of any distribution or payment attributable to such contributions shall not include such contributions but shall include the increments in value attributable to such contributions.

(iii) For purposes of applying section 72(m)(5)(D) and subdivisions (i)(b) and (iii) of § 1.72-17(e)(1) to recipient taxable years beginning after December 31, 1973, and beginning before January 1, 1976, in the case of distributions or payments made after December 31, 1973, the amounts to which section 402 (a)(2) or 403(a)(2) applies after the amendments made by section 2005(b) (1) and (2) of such Act (88 Stat. 990 and 991) (which are amounts to which subdivision (i)(b) of § 1.72-17(e)(1) does not apply) shall be deemed to be the amount which is treated as a gain from the sale or exchange of a capital asset held for more than 6 months under either of such sections.

(f) *Meaning of disabled.* (1) Section 72(m)(7) provides that an individual shall be considered to be disabled if he is unable to engage in any substantial

gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or to be of long-continued and indefinite duration. In determining whether an individual's impairment makes him unable to engage in any substantial gainful activity, primary consideration shall be given to the nature and severity of his impairment. Consideration shall also be given to other factors such as the individual's education, training, and work experience. The substantial gainful activity to which section 72(m)(7) refers is the activity, or a comparable activity, in which the individual customarily engaged prior to the arising of the disability or prior to retirement if the individual was retired at the time the disability arose.

(2) Whether or not the impairment in a particular case constitutes a disability is to be determined with reference to all the facts in the case. The following are examples of impairments which would ordinarily be considered as preventing substantial gainful activity:

- (i) Loss of use of two limbs;
- (ii) Certain progressive diseases which have resulted in the physical loss or atrophy of a limb, such as diabetes, multiple sclerosis, or Buerger's disease;
- (iii) Diseases of the heart, lungs, or blood vessels which have resulted in major loss of heart or lung reserve as evidenced by X-ray, electrocardiogram, or other objective findings, so that despite medical treatment breathlessness, pain, or fatigue is produced on slight exertion, such as walking several blocks, using public transportation, or doing small chores;
- (iv) Cancer which is inoperable and progressive;
- (v) Damage to the brain or brain abnormality which has resulted in severe loss of judgment, intellect, orientation, or memory;
- (vi) Mental diseases (e.g. psychosis or severe psychoneurosis) requiring continued institutionalization or constant supervision of the individual;
- (vii) Loss or diminution of vision to the extent that the affected individual has a central visual acuity of no better than 20/200 in the better eye after best

correction, or has a limitation in the fields of vision such that the widest diameter of the visual fields subtends an angle no greater than 20 degrees;

(viii) Permanent and total loss of speech;

(ix) Total deafness uncorrectible by a hearing aid.

The existence of one or more of the impairments described in this subparagraph (or of an impairment of greater severity) will not, however, in and of itself always permit a finding that an individual is disabled as defined in section 72(m)(7). Any impairment, whether of lesser or greater severity, must be evaluated in terms of whether it does in fact prevent the individual from engaging in his customary or any comparable substantial gainful activity.

(3) In order to meet the requirements of section 72(m)(7), an impairment must be expected either to continue for a long and indefinite period or to result in death. Ordinarily, a terminal illness because of disease or injury would result in disability. The term "indefinite" is used in the sense that it cannot reasonably be anticipated that the impairment will, in the foreseeable future, be so diminished as no longer to prevent substantial gainful activity. For example, an individual who suffers a bone fracture which prevents him from working for an extended period of time will not be considered disabled, if his recovery can be expected in the foreseeable future; if the fracture persistently fails to knit, the individual would ordinarily be considered disabled.

(4) An impairment which is remediable does not constitute a disability within the meaning of section 72(m)(7). An individual will not be deemed disabled if, with reasonable effort and safety to himself, the impairment can be diminished to the extent that the individual will not be prevented by the impairment from engaging in his customary or any comparable substantial gainful activity.

[T.D. 7636, 44 FR 47049, Aug. 10, 1979, as amended by T.D. 8894, 65 FR 46591, July 31, 2000]