under the other until his death, the capital gains treatment is applicable to the balance paid to his beneficiary on his death if paid within one taxable year of the beneficiary. The amount received by the employee on surrender of the contract in the year of his separation from the service, however, would not receive capital gains treatment since the balance to the credit of the employee with respect to all amounts under the plan did not become payable at that time.

(3) If an employee retires and commences to receive an annuity but subsequently in some succeeding taxable year, he is paid a lump sum in settlement of all future annuity payments, the capital gains treatment does not apply to such lump sum settlement paid during the lifetime of the employee since it is not a payment on account of separation from the service, or death after separation, but is on account of the settlement of future annuity payments.

(4) If the "total amounts" payable under all annuity contracts under the plan with respect to a particular employee are paid or includible in the gross income of several payees within one taxable year on account of the employee's death or other separation from the service or on account of his death after separation from the service, the capital gains treatment is applicable. Thus, if the balance to the credit of a deceased employee under all annuity contracts provided under an annuity plan becomes payable to two payees, the capital gains treatment is applicable provided the "total amounts" payable are received by or includible in the gross income of both payees within the same taxable year. However, if the "total amounts" payable are made available to each payee and one elects to receive his share in cash while the other makes a timely election under section 72(h) to receive his share as an annuity, the capital gains treatment does not apply to either payee.

(5) For purposes of determining whether the total amounts payable to an employee have been paid within one taxable year, the term "total amounts" includes amounts under a plan which are attributable to contributions on behalf of an individual while he was self-employed in the business with respect to which the plan was established. Thus, the "total amounts" payable are not paid within one taxable year if amounts remain payable which are so attributable.

(6) The term "total amounts" does not include any amount which has been placed in a separate account for the funding of benefits described in section 401(h). Thus, a distribution under a qualified annuity plan may constitute a distribution of the total amounts payable with respect to an employee even though amounts attributable to the funding of section 401(h) medical benefits as defined in paragraph (a) of §1.401–14 are not so distributed.

(c) The provisions of this section are not applicable to any amounts paid to a payee to the extent such amounts are attributable to contributions made on behalf of an employee while he was a self-employed individual in the business with respect to which the plan was established. For the taxation of such amounts, see §1.72–18. For the rules for determining the amount attributable to contributions on behalf of an employee while he was self-employed, see paragraphs (b)(4) and (c)(2) of such section.

[T.D. 6500, 25 FR 11681, Nov. 26, 1960, as amended by T.D. 6676, 28 FR 10143, Sept. 17, 1963; T.D. 6722, 29 FR 5073, Apr. 14, 1964]

§1.403(b)–1 Taxability of beneficiary under annuity purchased by a section 501(c)(3) organization or public school.

(a) *Amounts paid by employer during taxable years beginning before January 1, 1958*—(1) *In general.* If an amount is paid during a taxable year of an employee (or a retired or former employee) beginning before January 1, 1958, toward the purchase for such employee of an annuity contract and such purchase is not part of an annuity plan which meets the requirements of section 404(a)(2), then such amount is not required to be included in the gross income of such employee for such taxable year—

(i) If such amount is paid by an employer which, at the time of the payment, is an organization described in section 501(c)(3) and exempt from tax under section 501(a), and

(ii) If the purchase of the annuity contract is merely a supplement to the past or current compensation of such employee (within the meaning of subparagraph (2) of this paragraph).

For purposes of this paragraph, it is immaterial whether or not the employee's rights to the annuity contract are forfeitable.

(2) *Supplement to past or current compensation.* For purposes of this paragraph, whether the purchase of an annuity contract is merely a "supplement to past or current compensation" is to be determined by all the surrounding facts and circumstances. One of the pertinent facts to be taken into consideration is the ratio of the consideration paid by the employer for an employee's contract to the amount of his past or current compensation. For example, if the annual premium paid for an employee's contract is $1,000 and his annual salary is $10,000, the ratio indicates that the premium paid for the contract is merely a supplement to the employee's current compensation. If, however, an employee receives no current compensation, or the annual premiums paid for his annuity contract approximate his annual salary, the amount paid for his contract will be considered to be current compensation and taxable to the employee in the year in which it is paid by the employer. Other pertinent considerations are whether the annuity contract is purchased as a result of an agreement for a reduction of the employee's annual salary, or whether it is purchased at his request in lieu of an increase in current compensation to which he otherwise might be entitled. In such cases, the amount paid for the contract shall also be considered to be current compensation.

(b) *Amounts paid by employer during taxable years beginning after December 31, 1957*—(1) *In general.* If amounts are contributed by an employer during a taxable year of an employee (or a retired or former employee) beginning after December 31, 1957, toward the purchase for such employee of an annuity contract and such purchase is not part of an annuity plan which meets the requirements of section 404(a)(2), then, to the extent such amounts do not exceed the exclusion allowance for such taxable year, they are not required to be included in the gross income of such employee for such taxable year, if at the time of the contribution—

(i) The employer is an organization described in section 501(c)(3) and exempt from tax under section 501(a), or

(ii) The employer is a State, a political subdivision of a State, or an agency or instrumentality of any one or more of the foregoing, and the employee is performing (or has performed) services for an educational institution (as defined in section 151(e)(4)), and

(iii) The employee's rights under the annuity contract are nonforfeitable except for failure to pay future premiums.

See paragraph (d) of this section for rules relating to the computation of an employee's exclusion allowance for a taxable year.

(2) *Forfeitable rights which change to nonforfeitable rights.* If an employee's rights under an annuity contract change from forfeitable to nonforfeitable rights, the amount which, under section 403(d), is includible in the gross income of such employee by reason of such change (computed without regard to subparagraph (1) of this paragraph) shall, for purposes of subparagraph (1) of this paragraph, be considered an amount contributed by the employer for such annuity contract as of the time the employee's rights under the contract change to nonforfeitable rights. Such amount will, therefore, be excludable from the employee's gross income for the taxable year in which the change occurs to the extent that it is so excludable under the rules contained in this section. In determining the extent to which such amount is excludable, this section shall be applied in the same manner as in the case of current employer contributions. Thus, no part of such amount is excludable if the employer is not an employer described in subparagraph (1) of this paragraph at the time the employee's rights under the annuity contract change from forfeitable to nonforfeitable rights. In addition, such amount will be excludable only to the extent it does not exceed the employee's exclusion allowance for the taxable year in which the change occurs. Since such an

amount is considered as an amount contributed by the employer at the time the change occurs, it is immaterial whether the employer was an employer described in subparagraph (1) of this paragraph at the time the actual contributions were made.

(3) *Agreement to take a reduction in salary or to forego an increase in salary.* (i) There is no requirement that the purchase of an annuity contract for an employee must be merely a "supplement to past or current compensation" in order for the exclusion provided by this paragraph to apply to employer contributions for such annuity contract. Thus, the exclusion provided by this paragraph is applicable to amounts contributed by an employer for an annuity contract as a result of an agreement with an employee to take a reduction in salary, or to forego an increase in salary, but only to the extent such amounts are earned by the employee after the agreement becomes effective. Such an agreement must be legally binding and irrevocable with respect to amounts earned while the agreement is in effect. Except as provided in subdivision (ii) of this subparagraph, the employee must not be permitted to make more than one agreement with the same employer during any taxable year of such employee beginning after December 31, 1963; the exclusion provided by this paragraph shall not apply to any amounts which are contributed under any further agreement made by such employee during the same taxable year beginning after such date. However, the employee may be permitted to terminate the entire agreement with respect to amounts not yet earned.

(ii) An individual who is employed by an organization described in section 415(c)(4) may make a salary reduction agreement for his taxable year beginning in 1976 or 1977 at any time before the end of the 1976 or 1977 taxable year, respectively, without the agreement's being considered a new agreement within the meaning of this subparagraph. The agreement for 1976 may be made on or before June 15, 1977, and the agreement for 1977 may be made on or before April 17, 1978. This special rule only applies if the individual makes a statement of intention in accordance with §11.415(c)(4)–1(b) electing, or determines his income tax liability for the taxable year in a way which is consistent with, one of the alternative limitations under section 415(c)(4) for 1976 or 1977 (as the case may be). The salary reduction agreement for 1976 may be made effective with respect to any amount earned during the taxpayer's most recent one-year period of service (as defined in paragraph (f) of this section) ending not later than the end of the 1976 taxable year, notwithstanding subdivision (i) of this subparagraph. Similarly, the salary reduction agreement for 1977 may be made effective with respect to such period of service ending not later than the end of the 1977 taxable year. If the salary reduction agreement for 1976 is entered into at any time after December 31, 1976, or if the salary reduction agreement for 1977 is entered into at any time after December 31, 1977, an amended Form W–2 must be filed on behalf of the individual.

(iii) The rules of subdivision (i) of this subparagraph may be illustrated by the following example:

Example. A is an employee of X Organization (an employer described in section 501(c)(3) and exempt from tax under section 501(a)) for the entire calendar year 1964. A uses the calendar year as a taxable year. A's annual salary as of January 1, 1964, is $12,000. On February 1, 1964, A and his employer enter a binding and irrevocable agreement whereby A is to take a 10-percent reduction in salary (from $1,000 per month to $900 per month) and X Organization is to contribute $100 per month for an annuity contract described in section 403(b). The agreement also provides that A may terminate the entire agreement with respect to amounts not yet earned. Since the agreement to reduce A's salary and invest the amount of such reduction in an annuity contract was made after A earned his salary for January, A's current compensation for January is $1,000 even though the agreement may provide that X Organization shall contribute $100 with respect to January for the benefit of A for an annuity contract described in section 403(b). For February and subsequent months ending before July 1, 1964, X Organization contributes $100 per month for A's annuity. Thus, A's current compensation for each of these months is $900, and the $100 which is contributed during such months by X Organization for an annuity contract for A is an employer contribution to which the exclusion provided in this paragraph applies. On July 1, 1964, A

becomes entitled to a salary increase of $200 per month and, pursuant to the agreement of February 1, 1964, X Organization contributes 10 percent of such increase or an additional $20 per month for a section 403(b) annuity. For July and subsequent months ending before October 1, 1964, X Organization contributes $120 per month for A's annuity. Thus, A's current compensation for each of these months is $1,080, and the $120 which is contributed during such months by X Organization for an annuity contract for A is an employer contribution to which the exclusion provided in this paragraph applies. On November 1, 1964, A terminates the entire agreement with respect to amounts not yet earned. Since the termination occurred after A earned his salary for the month of October, the contribution for October is an employer contribution to which the exclusion provided in this paragraph applies. For the months November and December, A's full salary of $1,200 per month is includible in his gross income whether or not his employer makes contributions for a section 403(b) annuity.

(4) *Two or more annuity contracts.* If, during a taxable year of an employee, this paragraph applies to amounts contributed (including amounts which are considered to be contributed under subparagraph (2) of this paragraph) by his employer for two or more annuity contracts for such employee, such two or more annuity contracts shall, for such taxable year, be considered a single contract for purposes of applying the rules contained in this paragraph.

(5) *Employees performing services for public schools.* For purposes of this section, a person shall be considered an employee who performs services for an educational institution (as defined in section 151(e)(4)) if he is performing services as an employee directly or indirectly for such an institution. Thus, for example, the principal, clerical employees, custodial employees, and teachers at a public elementary school are employees performing services directly for such an educational institution. An employee who performs services involving the operation or direction of a State's, or political subdivision's, education program as carried on through educational institutions (as defined in section 151(e)(4)) is an employee performing services indirectly for such institutions. An employee participating in an "in-home" teaching program is included since such program is merely an extension of the activities carried on by such educational institutions. On the other hand, a person occupying an elective or appointive public office is not an employee performing services for an educational institution unless such office is one to which an individual is elected or appointed only if he has received training, or is experienced, in the field of education. The term "public office" includes any elective or appointive office of a State, a political subdivision of a State, or an agency or instrumentality of any one or more of the foregoing. Thus, for example, a regent or trustee of a State university or a member of a board of education is not an employee performing services for an educational institution. On the other hand, a commissioner or superintendent of education will generally be considered an employee performing services for an educational institution.

(c) *Taxation of amounts received under annuity contracts*—(1) *In general.* The amounts received by or made available to any employee under an annuity contract to which paragraph (a) or (b) of this section applies shall be included in the gross income of the employee for the taxable year in which received or made available, as provided in section 72 (relating to annuities). For taxable years beginning before January 1, 1964, section 72(e)(3) (relating to the treatment of certain lump sums), as in effect before such date, shall not apply to any amount received by or made available to any such employee under such an annuity contract. For taxable years beginning after December 31, 1963, amounts received or made available to any such employee under such annuity contract may be taken into account in computations under sections 1301 through 1305 (relating to income averaging).

(2) *Taxation of beneficiaries.* If, upon the death of an employee or of a retired employee, the widow or other beneficiary of such employee is paid, in accordance with the terms of the annuity contract relating to the deceased employee, an annuity or other death benefit, the extent to which the amounts received by or made available to the beneficiary must be included in the

beneficiary's income under subparagraph (1) of this paragraph shall be determined in accordance with the rules presented in paragraph (a)(5) of § 1.402(a)–1.

(3) *Life insurance protection.* An individual contract issued after December 31, 1962, or a group contract, which provides incidental life insurance protection may be purchased as an annuity contract to which paragraph (a) or (b) of this section applies. For the rules as to nontransferability of such contracts issued after December 31, 1962, see § 1.401–9. For the rules relating to the taxation of the cost of the life insurance protection and the proceeds thereunder, see § 1.72–16. Section 403(b) is not applicable to premiums paid after October 26, 1956, for individual contracts which were issued prior to January 1, 1963, and which provide life insurance protection.

(d) *Exclusion allowance*—(1) *In general.* For purposes of paragraph (b) of this section, an employee's exclusion allowance for a taxable year is an amount equal to the excess, if any, of—

(i) The amount determined by multiplying *(a)* 20 percent of such employee's includible compensation in respect of such taxable year, by *(b)* such employee's total number of years of service as of the close of such taxable year, over

(ii) The aggregate of (*a*) the amounts which have been contributed by the employer for annuity contracts for such employee and which were excludable from the gross income of the employee for any taxable year prior to the taxable year for which the exclusion allowance is being determined, and (*b*) the amounts of compensation excludable from the gross income of the employee under section 457(a) (relating to eligible State deferred compensation plans) for any prior taxable year that is taken into account as a year of service under paragraph (f) of this section. Compensation deferred under an eligible State deferred compensation plan shall be taken into account as described in subdivision (ii) of this subparagraph even if the entity sponsoring the eligible plan is not the employer purchasing the annuity contract with respect to which the employee's exclusion allowance is to be determined. See paragraph (e) of this section for the definition of an employee's includible compensation in respect of a taxable year and paragraph (f) of this section for rules for computing an employee's total number of years of service for an employer.

(2) *More than one employer.* If, during a taxable year of an employee, amounts are contributed for annuity contracts for such employee by two or more employers described in paragraph (b)(1) (i) or (ii) of this section, a separate exclusion allowance shall be computed with respect to each employer. In such a case, therefore, there shall not be taken into account, in computing the exclusion allowance with respect to one employer, the "includible compensation" received by the employee from any other employer, the employee's years of service with any other employer, or amounts which have been contributed by any other employer for annuity contracts for such employee.

(3) *Amounts previously contributed by the employer which were excludable from the employee's gross income.* In computing, for purposes of subparagraph (1)(ii) of this paragraph, the aggregate of the amounts which have been contributed by an employer for annuity contracts for an employee and which were excludable from the gross income of the employee for any taxable year prior to the taxable year for which the exclusion allowance is being determined, there shall be included all contributions made by the employer for the benefit of the employee—

(i) Which, under section 402(a) or section 403(a), were excludable from the employee's gross income for any such prior taxable year by reason of being contributions to a trust described in section 401(a) and exempt from tax under section 501(a) or contributions toward the purchase of an annuity contract under a plan which meets the requirements of section 404(a)(2) (whether forfeitable or nonforfeitable); or

(ii) Which, under section 405(d), were excludable from the employee's gross income for any such prior taxable year by reason of being contributions toward the purchase of United States bonds under a plan which meets the requirements of section 405(a)(1); or

(iii) Which were excludable from the employee's gross income for any such prior taxable year by reason of being contributions described in paragraph (a) or (b) of this section; or

(iv) *(a)* Which were excludable from the employee's gross income for the taxable year when made solely by reason of the fact that the employee's rights to such contributions were forfeitable at the time they were made (and not for any of the reasons described in subdivisions (i), (ii), and (iii) of this subparagraph);

(b) With respect to which the employee's rights changed to nonforfeitable rights prior to the taxable year for which the exclusion allowance is being determined; and

(c) Which were not, under section 403(d) and without regard to paragraph (b) of this section, includible in the employee's gross income for the taxable year in which his rights to such contributions changed from forfeitable to nonforfeitable rights.

For purposes of subdivisions (i) and (iii) of this subparagraph, all references to provisions of the Internal Revenue Code of 1954 and to provisions of the regulations under such Code shall also be considered references to the corresponding provisions of prior law and regulations. See subparagraph (4) of this paragraph for rules relating to the allocation of employer contributions to an employee where the actual contributions are not allocated among individual employees; or

(v) Which were contributions to a section 403(b) annuity contract for a prior taxable year and which exceeded the limitations of section 415(c)(1) applicable to the employee. See §1.415–6(e)(1)(ii) for a more detailed discussion of this rule. See also §1.415–9(c) for rules relating to the treatment of certain contributions to a section 403(b) annuity contract which are excess contributions because of the aggregation of the annuity contract with a qualified plan.

(4) *Determination of excludable amounts by allocation of contributions.* If, for any employee, the actual amounts of employer contributions to a defined benefit plan described in subparagraph (3) of this paragraph are not known, such amounts shall be determined under the formula described in this subparagraph or under any other method utilizing recognized actuarial principles which are consistent with the provisions of the plan under which such contributions are made and the method adopted by the employer for funding the benefits under the plan. If the formula described in this subparagraph is to be used, the contributions made by the employer for the benefit of the employee as of the end of any taxable year shall be deemed to be the product of the quantities described in subdivisions (i), (ii), (iii), and (iv) of this subparagraph. Such quantities are—

(i) The projected annual amount of the employee's pension (as of the end of the taxable year) to be provided at normal retirement age from employer contributions, based upon the provisions of the plan in effect at such time and upon the assumption of the employee's continued employment with his present employer at his then current salary rate.

(ii) The value, from Table I below, at normal retirement age of an annuity of $1.00 per annum payable in equal monthly installments during the life of the employee, based upon the normal retirement age as defined in the plan.

(iii) The amount from Table II below (representing the level annual contribution which will accumulate to $1.00 at normal retirement age) for the sum of *(a)* the number of years remaining from the end of the taxable year to normal retirement age and *(b)* the lesser of the number of years of service credited through the end of the taxable year or the number of years that the plan has been in existence at such time.

(iv) The lesser of the number of years of service credited through the end of the taxable year or the number of years that the plan has been in existence at such time.

TABLE I—VALUE AT NORMAL RETIREMENT AGES OF ANNUITY OF $1.00 PER ANNUM PAYABLE IN EQUAL MONTHLY INSTALLMENTS DURING THE LIFE OF THE EMPLOYEE

[For taxable years beginning after July 1, 1986]

Ages	Values
40	11.49
41	11.40
42	11.31

TABLE I—VALUE AT NORMAL RETIREMENT AGES OF ANNUITY OF $1.00 PER ANNUM PAYABLE IN EQUAL MONTHLY INSTALLMENTS DURING THE LIFE OF THE EMPLOYEE—Continued

[For taxable years beginning after July 1, 1986]

Ages	Values
43	11.22
44	11.12
45	11.01
46	10.91
47	10.79
48	10.68
49	10.56
50	10.43
51	10.30
52	10.18
53	10.04
54	9.89
55	9.75
56	9.60
57	9.44
58	9.28
59	9.13
60	8.96
61	8.79
62	8.62
63	8.44
64	8.25
65	8.08
66	7.88
67	7.70
68	7.50
69	7.29
70	7.10
71	6.88
72	6.68
73	6.46
74	6.25
75	6.03
76	5.82
77	5.61
78	5.40
79	5.20
80	4.99

NOTE: If the normal form of retirement benefit under the plan is other than a straight life annuity, the value from Table I above should be divided by the figure set forth below opposite the normal form of retirement benefit provided by the plan:

Annuity for 5 years certain and life thereafter	0.97
Annuity for 10 years certain and life thereafter	0.90
Annuity for 15 years certain and life thereafter	0.80
Annuity for 20 years certain and life thereafter	0.70
Life annuity with installment refund	0.80
Life annuity with cash refund[1]	0.75

[1] The term "cash refund" refers to refund of accumulated employer contributions, and does not refer to refund of employee contributions only, often referred to as "modified cash refund".

TABLE II—LEVEL ANNUAL CONTRIBUTION WHICH WILL ACCUMULATE TO $1.00 AT END OF NUMBER OF YEARS

[For taxable years beginning after July 1, 1986]

Number of years	Amounts
1	$1.0000
2	.4808
3	.3080
4	.2219
5	.1705
6	.1363
7	.1121
8	.0940
9	.0801
10	.0690
11	.0601
12	.0527
13	.0465
14	.0413
15	.0368
16	.0330
17	.0296
18	.0267
19	.0241
20	.0219
21	.0198
22	.0180
23	.0164
24	.0150
25	.0137
26	.0125
27	.0114
28	.0105
29	.0096
30	.0088
31	.0081
32	.0075
33	.0069
34	.0063
35	.0058
36	.0053
37	.0049
38	.0045
39	.0042
40	.0039
41	.0036
42	.0033
43	.0030
44	.0028
45	.0026
46	.0024
47	.0022
48	.0020
49	.0019
50	.0017

(5) *Election to have allowance determined under section 415 rules.* Under section 415(c)(4)(D), an employee may elect to have the provisions of section 415(c)(4)(C) (relating to special limitations for annuity contracts purchased by educational organizations, hospitals and home health service agencies) apply for a taxable year. If the employee so elects, his exclusion allowance is the maximum amount under

section 415 that could be contributed by the employer for the benefit of the employee if the annuity contract for the benefit of the employee were treated as a defined contribution plan maintained by the employer. Thus, the exclusion allowance for the taxable year of an employee who makes the election may not exceed the limitation on contributions and other additions (as described in §1.415–6) applicable to the employee for that taxable year. See §1.415–7 for provisions applicable in the event an employer maintains a defined benefit plan and a defined contribution plan for the same employee. See §1.415–8 for provisions applicable in the event an employer maintains more than one defined contribution plan covering the same employee.

(e) *Includible compensation*—(1) *In general.* For purposes of computing, under paragraph (d) of this section, an employee's exclusion allowance for a taxable year, such employee's includible compensation in respect of such taxable year means the amount of compensation from the employer—

(i) Which was earned during the most recent period (ending not later than the close of the employee's taxable year for which the exclusion allowance is being determined) that, under paragraph (f) of this section, may be counted as one-year of service,

(ii) Which is includible in the employee's gross income, and

(iii) In the case of an employee of an employer described in paragraph (b)(1)(ii) of this section, which is attributable to services performed for an educational institution (as defined in section 151(e)(4)).

See subparagraph (2) of this paragraph for special rules for determining the amount of compensation which is includible in the employee's gross income.

(2) *Special rules for determining the amount of compensation includible in the employee's gross income.* For purposes of subparagraph (1) of this paragraph, the amount of compensation which is includible in the employee's gross income shall be computed without regard to the exclusions allowed by section 105(d) (relating to wage continuation plans) and section 911 (relating to earned income from sources without the United States). Therefore, although amounts received by the employee from the employer while he is absent from work on account of personal injuries or sickness may be excludable from his gross income under section 105(d), such amounts are, nevertheless, considered as includible in his gross income for purposes of computing his includible compensation. On the other hand, in computing the amount which is includible in the gross income of the employee for purposes of subparagraph (1) of this paragraph, there shall not be included any amount which is contributed by the employer for an annuity contract to which paragraph (b) of this section applies. Thus, although the amount of any employer contributions for an annuity contract to which paragraph (b) of this section applies is, to the extent it exceeds in any taxable year the employee's exclusion allowance for such year, includible in the employee's gross income for that year, such amount is not considered as includible in the employee's gross income for purposes of computing his includible compensation for that year.

(3) *Period during which compensation must be earned.* For purposes of computing an employee's exclusion allowance for a taxable year, there may not be taken into account, as includible compensation, any compensation which was earned by the employee during a taxable year ending after the taxable year for which the exclusion allowance is being determined. On the other hand, an employee's includible compensation may include all or part of his compensation earned during a taxable year prior to the taxable year for which the exclusion allowance is being determined. Such a situation can occur, for example, when an employer purchases an annuity contract for a retired employee, or when an employer purchases an annuity contract for a part-time employee whose most recent one-year period of service (within the meaning of paragraph (f) of this section) extends over more than one taxable year of such employee. For purposes of this subparagraph, it is immaterial when the compensation is actually received by the employee or for what taxable year it is includible in his gross income.

(4) *Status of employer.* In computing an employee's exclusion allowance for a taxable year, there is not taken into account, as includible compensation, any compensation which was earned during a period when the employer was not an employer described in paragraph (b)(1) (i) or (ii) of this section since under paragraph (f)(2) of this section an employee is not considered to be in the service of the employer for any such period. On the other hand, it is immaterial whether the employer is an employer described in paragraph (b)(1) (i) or (ii) of this section at the time the compensation is actually received by the employee. Thus, if an employee receives compensation during his 1961 taxable year for services performed during his 1960 taxable year, such compensation can qualify as includible compensation if his employer was an employer described in paragraph (b)(1) (i) or (ii) of this section during 1960, even though such employer was not such an employer during 1961. See, also, paragraph (b) of this section which provides that the exclusion allowance is only applicable with respect to contributions which are made by an employer at a time when such employer is an employer described in paragraph (b)(1) (i) or (ii) of this section.

(f) *Years of service*—(1) *In general.* In computing an employee's exclusion allowance for a taxable year, it is necessary to determine such employee's number of years of service for the employer as of the close of such taxable year. For this purpose, the number of years of service of an employee for an employer shall be determined in accordance with the rules set forth in this paragraph. In addition, such rules are applicable in determining, for purposes of paragraph (e) of this section, an employee's most recent one-year period of service.

(2) *Exempt status requirement.* For purposes of determining an employee's number of years of service for an employer and his most recent one-year period of service for such employer, an employee shall not be considered to be employed by the employer, or to be in the service of the employer, during any period that the employer is not an employer described in paragraph (b)(1) (i) or (ii) of this section, or, in the case of an employee of an employer described in paragraph (b)(1)(ii) of this section, during any period when the employee is not performing services for an educational institution (as defined in section 151(e)(4)). The rule in this subparagraph may be illustrated by the following example: A was employed on a full-time basis by the X scientific organization during the whole of 1959 and 1960 and during half of 1961. Both A and the X Organization use the calendar year as their taxable year. The X Organization was an organization described in section 501(c)(3) and exempt from tax under section 501(a) during the years 1959 and 1961, but not during the year 1960. For purposes of determining A's exclusion allowance for 1961, he is considered to have 1½ years of service (his service during 1959 and 1961) and his most recent one-year period of service ending not later than the close of 1961 consists of his service during 1961 (which is equal to ½ year of service) and his service during the last half of 1959 (which is equal to another ½ year of service).

(3) *Service included.* For purposes of computing an employee's exclusion allowance for a taxable year, there may be taken into account, in determining his number of years of service, all service performed by him as of the close of such taxable year. Therefore, whenever possible, service performed during each of the employee's taxable years should be considered separately in arriving at his total number of years of service. For example, if an employee who reports his income on a calendar year basis is employed on a full-time basis on July 1, 1959, and continues on a full-time basis through December 31, 1960, his number of years of service as of the close of his 1960 taxable year should, if possible, be computed as follows:

(a) Number of years of service performed during 1959 taxable year	½
(b) Number of years of service performed during 1960 taxable year	1
(c) Total number of years of service as of close of 1960 taxable year (*(a)+(b)*)	1½

However, in determining what constitutes a full year of service, the employer's annual work period, and not the employee's taxable year, is the standard of measurement. For example, in determining whether a professor

is employed full time, the number of months in the school's academic year shall be the standard of measurement.

(4) *Full-time employee for full year.* (i) Each full year during which an individual was employed full time shall be considered as one year of service. In determining whether an individual is employed full-time, the amount of work which he is required to perform shall be compared with the amount of work which is normally required of individuals holding the same position with the same employer and who generally derive the major portion of their personal service income from such position.

(ii)*(a)* In measuring the amount of work required of individuals holding a particular position, any method that reasonably and accurately reflects such amount may be used. For example, the number of hours of classroom instruction is only an indication of the amount of work required, but it may be used as a measure.

(b) In determining whether positions with the same employer are the same, all of the facts and circumstances concerning the positions shall be considered, including the work performed, the methods by which compensation is computed, and the descriptions (or titles) of the positions. For example, an assistant professor employed in the English department of a university will be considered a full-time employee if the amount of work that he is required to perform is the same as the amount of work normally required of assistant professors of English at that university who derive the main portion of their personal service income from such position.

(c) In case an individual's position is not the same as another with his employer, the rules of this paragraph shall be applied by considering the same position with similar employers or similar positions with the same employer.

(iii) A full year of service for a particular position means the usual annual work period of individuals employed full-time in that general type of employment at the place of employment. For example, if a doctor employed by a hospital works throughout the 12 months of a year except for a one-month vacation, such doctor will be considered as being employed for a full year, if the other doctors at that hospital work 11 months of the year with a one-month vacation. Similarly, if the usual annual work period at a university consists of the fall and spring semesters, an instructor at that university who teaches those semesters will be considered as working a full year.

(5) *Other employees.* (i) An individual shall be treated as having a fraction of a year of service for each year during which he was a full-time employee for part of the year or for each year during which he was a part-time employee for the entire year or for a part of the year.

(ii) In determining the fraction which represents the fractional year of service for an individual employed full time for part of a year, the numerator shall be the number of weeks (or months) during which the individual was a full-time employee in a position during that year, and the denominator shall be the number of weeks (or months) which is considered under subparagraph (4)(iii) of this paragraph as the usual annual work period for that position. For example, if an instructor is employed full time by a university for the 1959 spring semester (which lasts from February 1959 through May 1959), and the academic year of the university is 8 months long, beginning in October 1958, and ending in May 1959, then he is considered as having completed ⅝ of a year of service.

(iii) In determining the fraction which represents the fractional year of service of an individual who is employed part time for a full year, the numerator shall be the amount of work required to be performed by the individual, and the denominator shall be the amount of work normally required of individuals who hold the same position. The amount of work required to be performed by the individual and the amount of work normally required of individuals holding the same position shall be determined in accordance with the principles of subparagraph (4) of this paragraph. Thus, if a practicing physician teaches one course at a local medical school 3 hours per week for two semesters and other faculty members at that medical school teach 9

hours per week for two semesters, then the practicing physician is considered as having completed 3/9 of a year of service.

(iv) In determining the fraction representing the fractional year of service of an individual who is employed part time for part of a year, it is necessary to compute the fractional year of service if the individual were a part-time employee for a full year, and the fractional year of service if the individual were a full-time employee for the part of a year. The two fractions shall be multiplied and the product is the fractional year of service of such individual who is employed part time for part of a year. For example, if an attorney who is a specialist in a subject teaches a course in that subject for 3 hours per week for one semester at a nearby law school, and the full-time instructors at that law school teach 12 hours per week for two semesters, then the fractional part of a year of service for such part-time instructor is computed as follows: The fractional year of service if the instructor were a part-time employee for a full year is 3/12 (number of hours employed divided by the usual number of hours of work required for that position); the fractional year of service if the instructor were a full-time employee for part of a year is 1/2 (period worked or one semester, divided by usual work period, or 2 semesters). These fractions are multiplied to obtain the fractional year of service: 3/12 times 1/2, or 3/24 (1/8).

(6) *Less than one year of service considered as one year.* If, at the close of a taxable year, an employee has, under the rules in this paragraph, a period of service of less than one year, such employee shall, nevertheless, be considered to have one year of service for purposes of computing his exclusion allowance for that taxable year. Such period of service of less than one year shall also be considered to be such employee's most recent one-year period of service for purposes of determining his includible compensation.

(7) *Most recent one-year period of service.* (i) In determining, for purposes of paragraph (e) of this section (relating to includible compensation), an employee's most recent one-year period of service, there is first taken into account all service performed by the employee during the taxable year for which the exclusion allowance is being determined. For this purpose, therefore, an employee's most recent one-year period of service may not be the same as his employer's most recent annual work period. The rule in this subdivision may be illustrated by the following example: A, a professor who reports his income on a calendar year basis, is employed by a university on a full-time basis during the university's 1959–1960 and 1960–1961 academic years (October through May). For purposes of computing A's exclusion allowance for his 1960 taxable year, his most recent one-year period of service consists of his service performed during January through May, 1960 (which is part of the 1959–1960 academic year) and his service performed during October through December 1960 (which is part of the 1960–1961 academic year).

(ii) In the case of a part-time employee or a full-time employee who is employed for only part of a year, it will be necessary to aggregate his most recent periods of service to determine his most recent one-year period of service. In such a case, there is first taken into account his service during the taxable year for which the exclusion allowance is being determined; then there is taken into account his service during his next preceding taxable year and so forth until his service equals, in the aggregate, one year of service. For example, if an employee, who reports his income on the calendar year basis, is employed on a full-time basis during the months July through December 1959 (1/2 year of service), July through December 1960 (1/2 year of service), and October through December 1961 (1/4 year of service), his most recent one-year period of service for purposes of computing his exclusion allowance for 1961 consists of his service during 1961 (1/4 year of service), his service during 1960 (1/2 year of service), and his service during the months October through December 1959 (1/4 year of service).

(g) *Illustration of computation of exclusion allowance.* The exclusion provided under paragraph (b) of this section may

be illustrated by the following example: A, a professor who reports his income on the calendar year basis, became a full-time employee of X University on October 1, 1958 (beginning of X University's 1958–1959 academic year) and continued as a full-time employee for the academic years 1958–1959, 1959–1960, and 1960–1961. X University was, during all such academic years, an organization described in section 501(c)(3) and exempt from tax under section 501(a). X University's academic year runs for a period of 8 months: October through May. A received an annual salary, all of which was includible in his gross income, of $8,000 for the 1958–1959 academic year, $8,800 for the 1959–1960 academic year, and $9,600 for the 1960–1961 academic year. Starting in 1958, X University contributed amounts toward the purchase of annuity contracts for A and such purchase was not part of a qualified annuity plan. X University paid, as premiums for such contracts, $1,000 in 1958, $2,000 in 1959, $2,400 in 1960, and $1,400 in 1961. The amount of such premiums which is excludable from A's gross income for the year in which paid is computed as follows:

1958

(1) Amount contributed by employer for annuity contracts in 1958	$1,000.00
(2) Includible compensation for most recent one-year period of service (since A was employed for only 3/8 of a year at the close of 1958, this period is counted as most recent one-year period of service) 3/8 × $8,000	$3,000.00
(3) 20% × includible compensation	$600.00
(4) Number of years of service (although A was employed for less than a year, he is considered to have one-year of service)	1
(5) Item (4) × item (3)	$600.00
(6) Contributions excludable in prior taxable years of A	None
(7) Amount excludable from A's gross income for 1958 ((5)—(6))	$600.00
(8) Amount includible in A's gross income for 1958 ((1) − (7))	$400.00

1959

(9) Amount contributed by employer for annuity contracts in 1959	$2,000.00
(10) Includible compensation for most recent one-year period of service. (3/8 × $8,800+5/8×$8,000)	$8,800.00
(11) 20% × includible compensation	$1,660.00
(12) Number of years of service	1 3/8
(13) Item (12) × item (11)	$2,282.50
(14) Contributions excludable in prior taxable years of A (item 7))	$600.00
(15) Amount excludable from A's gross income for 1959 ((13) − (14))	$1,682.50
(16) Amount includible in A's gross income for 1959 ((9) − (15))	$317.50

1960

(17) Amount contributed by employer for annuity contracts in 1960	$2,400.00
(18) Includible compensation for most recent one-year period of service (3/8×$9,600+5/8×$8,800)	$9,100.00
(19) 20% × includible compensation	$1,820.00
(20) Number of years of service	2 3/8
(21) Item (20) × item (19)	$4,322.50
(22) Contributions excludable in prior taxable years ((7) + (15))	$2,282.50
(23) Amount excludable from A's gross income for 1960 ((21) − (22))	$2,040.00
(24) Amount includible in A's gross income for 1960 ((17) − (23))	$360.00

1961

(25) Amount contributed by employer for annuity contracts in 1961	$1,400.00
(26) Includible compensation for most recent one-year period of service (5/8 × $9,600+3/8×$9,600)	$9,600.00
(27) 20% × includible compensation	$1,920.00
(28) Number of years of service	3
(29) Item (28) × item (27)	$5,760.00
(30) Contributions excludable in prior taxable years ((7) + (15) + (23))	$4,322.50
(31) Amount excludable from A's gross income for 1961 (item (25) since it is less than (29) − (30))	$1,400.00
(32) Amount includable in A's gross income for 1961 ((25) − (31))	None

[T.D. 6783, 29 FR 18360, Dec. 24, 1964, as amended by T.D. 6885, 31 FR 7802, June 2, 1966; T.D. 7748, 46 FR 1696, Jan. 7, 1981; T.D. 7836, 47 FR 42337, Sept. 27, 1982; T.D. 8115, 51 FR 45736, Dec. 19, 1986]

§ 1.403(b)–2 Eligible rollover distributions; questions and answers.

The following questions and answers relate to eligible rollover distributions from annuities, custodial accounts, and retirement income accounts described in section 403(b) of the Internal Revenue Code of 1986, as amended by sections 521 and 522 of the Unemployment Compensation Amendments of 1992 (Public Law 102–318, 106 Stat. 290) (UCA). For additional UCA guidance under sections 401(a)(31), 402(c), 402(f), and 3405(c), see §§ 1.401(a)(31)–1, 1.402(c)–2, 1.402(f)–1, and § 31.3405(c)–1 of this chapter, respectively.

LIST OF QUESTIONS