which would be includible in the employee's gross income for the taxable year if his entire beneficial interest in the annuity contract had changed to a nonforfeitable interest during such year. The amount that is includible (without regard to any exclusion allowed by paragraph (b) of § 1.403(b)–1) in the gross income of the employee for the taxable year in which the change occurs is an amount equal to the amount determined under the preceding sentence multiplied by the percent of the employee's beneficial interest which changed to a nonforfeitable interest during the taxable year. If at the time the employee's interest changes to a nonforfeitable interest, the employer is an organization described in section 501(a)(3) and exempt from tax under section 501(a), then the amount that is includible in the employee's gross income under this subparagraph is considered as an employer contribution to which the exclusion provided in paragraph (b) of § 1.403(b)–1 applies (see paragraph (b)(2) of § 1.403(b)–1).

(2) *Example.* The provisions in paragraph (c)(1) of this section may be illustrated by the following example:

Example. X organization purchased an annuity contract for A, one of its employees who reports his income on a calendar year basis. X contributed ⅓ of of amount necessary to purchase the contract before January 1, 1958, and the remaining ⅔ after December 31, 1957. At the time of the contributions, X was an organization exempt from tax under section 501(a) and A's rights under the contract were forfeitable. The annuity contract was not purchased as part of a qualified plan and A made no contributions toward the purchase of the contract. On December 31, 1965, 50 percent of A's interest in the contract changed from a forfeitable to a nonforfeitable interest, and on December 31, 1968, the remaining 50 percent of A's interest in the contract changed to a nonforfeitable interest. The cash surrender value of the contract was $9,900 on December 31, 1965, and $12,000 on December 31, 1968. The amount includible in A's gross income for 1965 and 1968 is computed as follows—

1965

(i) Amount which would have been includible if A's entire interest had changed to a nonforfeitable interest (cash surrender value of contract on December 31, 1965, attributable to contributions made after December 31, 1957), ⅔ × $9,900, $6,600.

(ii) Percent of A's interest that changed to a nonforfeitable interest on December 31, 1965, 50 percent.

(iii) Amount includible in A's gross income for 1965 ((ii)×(i)), $3,300.

1968

(iv) Amount which would have been includible if A's entire interest had changed to a nonforfeitable interest (cash surrender value of contract on December 31, 1968, attributable to contributions made after December 31, 1957), ⅔ $12,000, $8,000.

(v) Percent of A's interest that changed to a nonforfeitable interest on December 31, 1968, 50 percent.

(vi) Amount includible in A's gross income for 1968 ((v)×(iv)), $4,500.

If, on December 31, 1965, X is an organization described in section 501(c)(3) and exempt from tax under section 501(a), then only so much of the $3,300 as is not excludable under paragraph (b) of § 1.403(b)–1 is includible in A's gross income for 1965. Similarly, if, on December 31, 1968, X is an organization described in section 501(c)(3) and exempt from tax under section 501(a), then only so much of the $4,000 as is not excludable under paragraph (b) of § 1.403(b)–1 is includible in A's gross income for 1968.

(Secs. 83 and 7805 of the Internal Revenue Code of 1954 (83 Stat. 588; 68A Stat. 917; 26 U.S.C. 83 and 7805))

[T.D. 6783, 29 FR 18365, Dec. 24, 1964, as amended by T.D. 7554, 43 FR 31925, July 24, 1978]

§ 1.404(a)–1 Contributions of an employer to an employees' trust or annuity plan and compensation under a deferred payment plan; general rule.

(a)(1) Section 404(a) prescribes limitations upon deductions for amounts contributed by an employer under a pension, annuity, stock bonus, or profit-sharing plan, or under any plan of deferred compensation. It is immaterial whether the plan covers present employees only, or present and former employees, or only former employees. Section 404(a) also governs the deductibility of unfunded pensions and death benefits paid directly to former employees or their beneficiaries (see § 1.404(a)–12). For taxable years beginning after 1962, certain self-employed individuals may be covered by pension, annuity, or profit-sharing plans. For the rules relating to the deduction of contributions on behalf of such individuals, see paragraph (a)(2) of § 1.404(a)–8 and § 1.404(e)–1.

(2) Section 404(a) does not apply to a plan which does not defer the receipt of compensation. Furthermore, section 404(a) does not apply to deductions for contributions under a plan which is solely a dismissal wage or unemployment benefit plan, or a sickness, accident, hospitalization, medical expense, recreation, welfare, or similar benefit plan, or a combination thereof. For example, if under a plan an employer contributes 5 percent of each employee's compensation per month to a fund out of which employees who are laid off will be paid benefits for temporary periods, but employees who are not laid off have no rights to the funds, such a plan is an unemployment benefit plan, and the deductibility of the contributions to it is determined under section 162. As to the deductibility of such contributions, see § 1.162–9.

(3) If, however, the contributions to a pension, profit-sharing, stock bonus, or other plan of deferred compensation can be used to provide any of the benefits referred to in subparagraph (2) of this paragraph, then, except as provided in section 404(c), section 404(a) applies to the entire contribution to the plan. Thus, if in the example described in subparagraph (2) of this paragraph, the employer's contribution on behalf of each employee is set up as a separate account, and if any amount which remains in an employee's account at the time of retirement is paid to him at such time, the deductibility of the contributions to the plan is determined under section 404(a). For the regulations for determining whether the benefits referred to in subparagraph (2) of this paragraph can be included in a qualified pension or profit-sharing plan, see § 1.401–1(b).

(4) As to inclusion of full-time life insurance salesmen within the class of persons considered to be employees, see section 7701(a)(20).

(b) In order to be deductible under section 404(a), contributions must be expenses which would be deductible under section 162 (relating to trade or business expenses) or 212 (relating to expenses for production of income) if it were not for the provision in section 404(a) that they are deductible, if at all, only under section 404(a). Contributions may therefore be deducted under section 404(a) only to the extent that they are ordinary and necessary expenses during the taxable year in carrying on the trade or business or for the production of income and are compensation for personal services actually rendered. In no case is a deduction allowable under section 404(a) for the amount of any contribution for the benefit of an employee in excess of the amount which, together with other deductions allowed for compensation for such employee's services, constitutes a reasonable allowance for compensation for the services actually rendered. What constitutes a reasonable allowance depends upon the facts in the particular case. Among the elements to be considered in determining this are the personal services actually rendered in prior years as well as the current year and all compensation and contributions paid to or for such employee in prior years as well as in the current year. Thus, a contribution which is in the nature of additional compensation for services performed in prior years may be deductible, even if the total of such contributions and other compensation for the current year would be in excess of reasonable compensation for services performed in the current year, provided that such total plus all compensation and contributions paid to or for such employee in prior years represents a reasonable allowance for all services rendered by the employee by the end of the current year. A contribution under a plan which is primarily for the benefit of shareholders of the employer is not deductible. Such a contribution may constitute a dividend within the meaning of section 316. See also §§ 1.162–6 and 1.162–8. In addition to the limitations referred to above, deductions under section 404(a) are also subject to further conditions and limitations particularly provided therein.

(c) Deductions under section 404(a) are generally allowable only for the year in which the contribution or compensation is paid, regardless of the fact that the taxpayer may make his returns on the accrual method of accounting. Exceptions are made in the case of overpayments as provided in paragraphs (1), (3), and (7) of section 404(a), and, as provided by section

404(a)(6), in the case of payments made by a taxpayer on the accrual method of accounting not later than the time prescribed by law for filing the return for the taxable year of accrual (including extensions thereof). This latter provision is intended to permit a taxpayer on the accrual method to deduct such accrued contribution or compensation in the year of accrual, provided payment is actually made not later than the time prescribed by law for filing the return for the taxable year of accrual (including extensions thereof), but this provision is not applicable unless, during the taxable year on account of which the contribution is made, the taxpayer incurs a liability to make the contribution, the amount of which is accruable under section 461 for such taxable year. See section 461 and the regulations thereunder. There is another exception in the case of certain taxpayers who are required to make additional contributions as a result of the Act of June 15, 1955 (Public Law 74, 84th Cong., 69 Stat. 134), and the regulations thereunder.

[T.D. 6500, 25 FR 11682, Nov. 26, 1960, as amended by T.D. 6676, 28 FR 10144, Sept. 17, 1963]

§ 1.404(a)–1T Questions and answers relating to deductibility of deferred compensation and deferred benefits for employees. (Temporary)

Q–1: How does the amendment of section 404(b) by the Tax Reform Act of 1984 affect the deduction of contributions or compensation under section 404(a)?

A–1: As amended by the Tax Reform Act of 1984, section 404(b) clarifies that section 404(a) shall govern the deduction of contributions paid and compensation paid or incurred by the employer under a plan, or method or arrangement, deferring the receipt of compensation or providing for deferred benefits to employees, their spouses, or their dependents. See section 404(b) and § 1.404(b)–1T. Section 404 (a) and (d) requires that such a contribution or compensation be paid or incurred for purposes of section 162 or 212 and satisfy the requirements for deductibility under either of those sections. However, notwithstanding the above, section 404 does not apply to contributions paid or accrued with respect to a "welfare benefit fund" (as defined in section 419(e)) after July 18, 1984, in taxable years of employers (and payors) ending after that date. Also, section 463 shall govern the deduction of vacation pay by a taxpayer that has elected the application of such section. For rules relating to the deduction of contributions paid or accured with respect to a welfare benefit fund, see section 419, § 1.419–1T and § 1.419A–2T. For rules relating to the deduction of vacation pay for which an election is made under section 463, see § 301.9100–16T of this chapter and § 1.463–1T.

[T.D. 8073, 51 FR 4320, Feb. 4, 1986, as amended by T.D. 8435, 57 FR 43896, Sept. 23, 1992]

§ 1.404(a)–2 Information to be furnished by employer claiming deductions; taxable years ending before December 31, 1971.

(a) For the first taxable year for which a deduction from gross income is claimed under section 404(a) (1), (2), (3), or (7), the employer must file the following information (unless such information has been previously filed in accordance with the regulations under section 23(p) of the Internal Revenue Code of 1939) for each plan involved to establish that it meets the requirements of section 401(a) or 404(a)(2), and that deductions claimed do not exceed the amount allowable under paragraphs (1), (2), (3), and (7) of section 404(a), as the case may be:

(1) Verified copies of all the instruments constituting or evidencing the plan, including trust indentures, group annuity contracts, specimen copy of each type of individual contract, and specimen copy of formal announcement and comprehensive detailed description to employees, with all amendments to any such instruments.

(2) A statement describing the plan which identifies it and which sets forth the name or names of the employers, the effective date of the plan and of any amendments thereto, the method of distribution or of disbursing benefits (whether by trustee, insurance company, or otherwise), the dates when the instruments or amendments were executed, the date of formal announcement and the dates when comprehensive detailed description of the plan