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Tax-Sheltered Annuity Programs for Employees of Public Schools and Certain Tax-Exempt Organizations

For use in preparing

1995 Returns

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Introduction

This publication explains the federal tax provisions that apply to tax-sheltered annuities offered to employees of public schools and certain tax-exempt organizations. The publication is for employees who participate in tax-sheltered annuity plans. It is not for custodians or plan administrators because it does not cover the requirements of these plans.

Tax-sheltered annuity (TSA). A tax-sheltered annuity, often referred to as a ''403(b) plan,'' ''tax-deferred annuity,'' or ''TSA'' (which is used in this publication), is a retirement plan that gets tax-deferred treatment.

The TSA can provide for investing funds in annuity contracts, in custodial accounts holding mutual fund shares, or in retirement income accounts (defined contribution plans maintained by churches or certain church-related organizations). Throughout this publication, wherever ''TSA'' appears, it refers to any one of these funding arrangements, unless otherwise specified.

Special tax advantages. The benefit of a TSA is that you delay paying taxes on your employer's contributions to your TSA and on its earnings by excluding them from income until you receive the annuity payments. Generally, you receive annuity payments after you retire. At that time your income and your tax rate may be lower.

Employer contributions to TSA. Employers contribute to a TSA primarily through a salary reduction agreement. Under this agreement, you (the employee) agree to take a reduction in salary or to forego a salary increase and your employer agrees to contribute the amount of the salary reduction or the foregone salary increase toward the purchase of your TSA. These employer contributions are called ''elective deferrals.'' See *Salary Reduction Agreement,* later for more information.

This publication primarily covers elective deferrals, which are made under a salary reduction agreement. However, a TSA can also be funded through non-elective employer contributions, after-tax employee contributions, or a combination of these.

Limits on contributions. You can exclude from income employer contributions (including elective deferrals) to your TSA. However, the amount you exclude for a tax year cannot exceed any of the following limits discussed later:

1) Limit on elective deferrals,
2) The exclusion allowance, and
3) Limit on employer contributions.

You may be able to use an alternative limit to increase the amount you can exclude. See *Catch-up Election for Certain Employees.*

Excess contributions. You must include in your income the part of the contributions to your TSA that exceeds any of the limits above in the taxable year of the excess. Further, if you have an excess because the contributions exceed the limit in 3), that excess reduces the amount of your exclusion allowance for future years, even though the excess has already been included in your income.

For more information on the treatment of excess contributions, see *Treatment of excess deferrals*, *Exclusion from Gross Income*, *Limit on Employer Contributions*, and *Tax on Excess Contributions to a Custodial Account* (under *Other Rules*).

Only elective deferrals. To avoid an excess deferral if the contributions are solely elective deferrals, the total must not exceed the smallest of the limits in the preceding list.

Both elective deferrals and nonelective contributions. If the total contributions include both elective deferrals and nonelective contributions and the limit in 1) is the smallest of the limits in the preceding list, any part of the elective deferrals that exceeds the limit in 1) is an excess deferral; and any part of the total of all contributions (including the elective deferrals) that exceeds the smaller of the limit in 2) or 3) is an excess contribution.

Only nonelective contributions. If the total contributions include only nonelective contributions, only limits 2) and 3) apply.

More than one TSA. If for any tax year elective deferrals are contributed to more than one TSA for you (whether or not with the same employer), you must combine all the elective deferrals to determine whether the total exceeds the limit for that year. See *Limit on Elective Deferrals.*

Worksheets for limits. You can use the worksheets at the end of this publication to figure the contribution limits that apply to you.

Other information. The *Other Rules* section includes discussions on the taxability of the cost of insurance under a TSA, and on employer contributions subject to social security and Medicare taxes. For detailed information on the tax treatment of retirement income (including income from a TSA) and how to report it on your federal income tax return, get Publication 575, *Pension and Annuity Income (Including Simplified General Rule).*

Useful Items

You may want to see:

Publication

- ☐ **575** Pension and Annuity Income (Including Simplified General Rule)
- ☐ **590** Individual Retirement Arrangements (IRAs)

Form (and Instructions)

- ☐ **W–2** Wage and Tax Statement
- ☐ **1099-R** Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.
- ☐ **5330** Return of Excise Taxes Related to Employee Benefit Plans

Ordering publications and forms. To order free publications and forms, call 1–800–TAX–FORM (1–800–829–3676). You can also write to the IRS Forms Distribution Center nearest you. Check your income tax package for the address.

If you have access to a personal computer and a modem, you can also get many forms and publications electronically. See *How To Get Forms and Publications* in your income tax package for details.

Telephone help for hearing-impaired persons. If you have access to TDD equipment, you can call **1-800-829-4059** with your tax questions or to order forms and publications. See your tax package for the hours of operation.

Qualified Employer

A qualified employer can purchase tax-sheltered annuities for eligible employees. Two types of employers qualify—public schools and certain tax-exempt organizations.

Public Schools

A state or local government or any of its agencies or instrumentalities can be a qualified employer. It is a qualified employer only for employees who perform (or have performed) services, directly or indirectly, for an ***educational organization.*** For this purpose, an Indian tribal government is a state government.

An ***educational organization*** is one that normally maintains a regular faculty and curriculum, and normally has a regularly enrolled body of students in attendance at the place where it regularly carries on educational activities.

Tax-Exempt Organizations

Generally, a qualified employer includes an organization that is tax exempt because it is organized and operated exclusively for religious, charitable, scientific, public safety testing, literary, or educational purposes. It also includes a tax-exempt organization that is organized and operated exclusively to encourage national or international amateur sports competition, or for the prevention of cruelty to children or animals. The organization can be a corporation, community chest, fund, or foundation.

A cooperative hospital service organization that meets certain requirements is a qualified employer.

Government instrumentalities (other than public schools, described earlier) that are wholly-owned state or municipal instrumentalities generally are not qualified employers. However, if the organization is a ***separate entity*** that is specifically tax exempt because it is organized and operated only for the charitable, etc., purposes already stated, it is a qualified employer. A separately organized school, college, university, or hospital may qualify if it is not an activity under a branch or department of a state or municipal government.

Uniformed Services University of the Health Sciences. This is a federal organization authorized to train medical students for the uniformed services. The rules in this publication apply to annuities bought for civilian faculty and staff for work they performed after 1979.

Eligible Employees

A qualified employer can purchase tax-sheltered annuities only for eligible employees. If you are subject to the will and control of an employer regarding what work you do and how you do it, you are an employee. Full- or part-time employment is not a factor in determining whether you are an employee. If you are subject to the control or direction of another as to the result only, and not how you do the work, you will generally be an independent contractor, and not a qualified employee.

Your employer may be able to help you determine whether you are an eligible employee.

Employees of Public School Systems

You are considered eligible if you perform services as an employee, either directly or indirectly, for a public school. For example, the principal, clerical employees, custodial employees, and teachers at a public elementary school are employees performing services directly for an educational organization.

If you do not work in a school, but are involved in the operation or direction of the educational program carried out in public schools, you are an eligible employee performing services indirectly for public schools. Also, you are an eligible employee if you are participating in an ***in-home*** teaching program since the program is merely an extension of the activities carried on by public schools.

Department of Education employees appointed by a state commissioner of education. Janitorial, custodial, and general clerical employees indirectly perform services for an educational organization and are eligible employees. If you have a significant degree of executive or policymaking authority, and your appointment is based on required training or experience in the field of education, you also indirectly perform service for an educational organization and are an eligible employee.

Elected or appointed to office. If you occupy an elective or appointive office, you may be an eligible employee. You are an eligible employee if your office is one to which a person is elected or appointed only if he or she has received training, or is experienced, in the field of education.

A commissioner or superintendent of education generally is considered an employee performing services for an educational organization. However, a university regent or trustee, or a member of a board of education, is not an eligible employee.

Employees of a state teachers' retirement system. Employees of a retirement system that administers a state teachers' retirement program are ***not*** eligible to participate in a tax-sheltered annuity program because employees are not performing services directly or indirectly for an educational organization.

Employees of Qualified Tax-Exempt Organizations

Qualified tax-exempt organizations can purchase tax-sheltered annuities for some or all of their employees. Employees of a qualified tax-exempt organization include individuals who perform services as social workers, members of the clergy, teachers, professors, clerks, secretaries, etc.

A physician who works in a hospital as an employee may be eligible. Eligibility depends upon the amount of supervision and control of the services performed and other factors.

A physician is an employee, for example, if, by agreement, he or she:

- Does not take on outside duties that would negatively affect primary services to the hospital,
- Does not furnish services to other hospitals without the employer's consent,
- Obeys all rules and regulations of the hospital, and
- Receives a pay adjustment if the percentage of pay is less than an amount guaranteed by the agreement.

However, not all physicians who perform services for a hospital are employees. For example, a physician who performs services as a director of a hospital's department of pathology is ***not*** an employee if the physician:

- Receives a percentage of the department's income for the services,
- Pays an associate or substitute,
- Is allowed to privately practice medicine,
- Is not entitled to regular employee fringe benefits, or
- Is not subject to the general rules that apply to the hospital's employees.

Each case must be decided on its own facts and circumstances. No set rule will apply to all cases.

Salary Reduction Agreement

The most prevalent method for contributing to tax-sheltered annuities is through a salary reduction agreement. A salary reduction agreement is an agreement between the employer and employee under which the employee takes a reduction in salary or foregoes a salary increase and has the employer contribute that amount to the tax-sheltered annuity (TSA).

Elective deferrals. Amounts contributed under the salary reduction agreement, and used by the employer to invest in a TSA for the employee, are employer contributions generally called ''elective deferrals.''

However, an employer contribution to a TSA is not treated as an elective deferral if it is made as a condition of employment or as a one-time choice by the employee when he or she first becomes eligible to participate in the agreement. If you can modify or terminate your election to participate, the election is not a one-time choice and the contributions are elective deferrals.

How the agreement works. You may exclude from income only amounts that you earned after the agreement became effective. The agreement must be legally binding and irrevocable for amounts earned while the agreement is in effect. You cannot enter into more than one agreement with the same employer during a tax year. The exclusion will not apply to contributions under any further agreement made with the same employer during the same tax year. However, you may end the agreement for amounts not yet earned.

A continuing salary reduction agreement entered into in an ***earlier*** tax year does not prevent you from entering into a new salary reduction agreement at any time during the current tax year.

An agreement can base contributions on a prescribed percentage of your salary rather than a fixed dollar amount. The mere change in your employer's contribution because of an increase or decrease in your salary will not constitute a new agreement.

Similarly, changing insurers during a tax year in which a salary reduction agreement was made will not result in a new agreement for that year, even though the agreement initially specified the first insurer by name.

Example. During your entire 1995 tax year, you were employed as a teacher by the Central City School for the Deaf, a qualified employer. You use the calendar year as your tax year. As of January 1, 1995, your annual salary is $36,000.

On February 1, 1995, you and the school enter into a binding and irrevocable agreement. The agreement is retroactive to January 1, and requires you to take a 10% reduction in salary (from $3,000 a month to $2,700 a month) in return for the school's contribution of $300 a month for your annuity contract. The agreement further provides that you can end the entire agreement for amounts not yet earned. Since the agreement was made after you earned your salary for January, your taxable salary for January is $3,000, even though the school contributes $300 for that month.

For February through June, the school contributes $300 a month on your behalf to the plan. Thus, your current salary for each of these months is $2,700. The $300 that the school contributes for each of these months is subject to three limits. See *Introduction.*

On July 1, 1995, you receive a salary increase of $200 a month. Under the agreement of February 1, the school contributes 10% of this increase, or an additional $20 a month, to your annuity. For July through September, the school contributes $320 a month to the plan on your behalf. Your taxable salary for each of these months is $2,880. The $320 per month contribution is subject to the three limits. This assumes you satisfy the other requirements for tax-sheltered treatment.

On November 1, you end the entire agreement for amounts not yet earned. Since you terminated the agreement after you earned your salary for October, the contribution for October receives tax-sheltered treatment. For November and December, your full salary of $3,200 a month is includible in gross income.

Avoid excess contributions. Your employer may contribute under the salary reduction agreement an amount in excess of the limits. To avoid excess contributions, which you must include in income, be careful to ensure that (if the employer's contributions are only elective deferrals) the total for the year is no greater than the smallest of the:

1) Limit on elective deferrals,
2) Exclusion allowance, and
3) Limit on employer contributions,

which are discussed later. In no event may the elective deferrals exceed $9,500 for the year (or $12,500 if the discussion on the *Increase for 15-year employees* under *Limit on Elective Deferrals,* later, applies to you).

Alternative limits. To increase the amount that can be contributed to your TSA without having any of the contribution included in your income as an excess contribution, you may want to consider electing one of the alternative limits available (if you qualify). These limits are discussed later under *Catch-up Election for Certain Employees.*

Limit on Elective Deferrals

In addition to the limit on the exclusion allowance and the limit on employer contributions (these limits are discussed later), which apply to tax-sheltered annuity (TSA) contributions, there is an annual limit on combined elective deferrals.

Your employer's plan may permit you to have part of your pay contributed by your employer to a retirement fund, rather than have it paid to you. These employer contributions are called ''elective deferrals'' because you choose (or elect) to set aside the money, and tax on the money is deferred until it is distributed to you.

Elective deferrals include the total of all these deferrals contributed (even if contributed by different employers) on your behalf to:

- Cash or deferred arrangements (known as section 401(k) plans) to the extent excluded from your gross income,
- Section 501(c)(18) plans created before June 25, 1959 and only to the extent excluded from your gross income,
- Simplified employee pension (SEP) plans, and
- Tax-sheltered annuities.

A combined limit applies to the total amount that you can defer each tax year under these plans. Generally, you cannot defer more than an allowable amount each year for all plans covering you. (This limit applies without regard to community property laws.) If you defer more than the allowable amount for a tax year, you must include the excess in your gross income for that year (see *Treatment of excess deferrals,* later).

Limit for tax-sheltered annuities. If you are covered by only one plan, and that plan is a TSA, you can defer up to $9,500 each year. If you are covered by different plans and at least one of the plans is a TSA, then the basic limit of $9,240 for 1995 for all elective deferrals is increased by the amount deferred in the TSA that year, up to an overall total of $9,500.

Increase for 15-year employees. If you have completed at least 15 years of service with an educational organization, hospital, home health service agency, health and welfare service agency, church, or convention or association of churches (or associated organization), the $9,500 limit is increased each tax year. The limit is increased by the ***smallest*** of the following:

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

For example, if you qualify you may increase your elective deferrals to $12,500. For the computation, see Step 2 of Worksheet 6.

Cost-of-living adjustment. For 1995, the basic limit on elective deferrals is $9,240. This limit may be increased for inflation to reflect increases in the Consumer Price Index in future years.

> ***WORKSHEET 6*** at the end of this publication will help you figure the **Limit on Elective Deferrals**.

Excess deferrals. Excess deferrals are elective deferrals that exceed the limit on elective deferrals.

Treatment of excess deferrals. If the total you defer for a tax year is more than the limit for the year, you must include the excess in your gross income for that year on line 7 of Form 1040. If the plan permits, you may receive the excess amount.

If only one plan is involved and it permits the distribution of the excess amount, you must notify the plan by March 1 after the end of the tax year that an excess was deferred. The plan must then pay you the excess, along with any income on that amount, by April 15.

If more than one plan is involved, you may have the excess paid out of any of the plans that permit these distributions. You must notify each plan by March 1 of the amount to be paid from that particular plan, and the plan must then pay you that amount by April 15.

If you take out the excess by the required date, do not include it again in your gross income and do not subject it to the additional 10% tax for premature distributions. Any ***income*** on the excess taken out is taxable in the tax year you take it out.

If you take out ***part*** of the excess deferral and the income on it, you must treat the distribution as if ratably received from the excess deferral and the income on it. For example, assume that your excess deferral is $1,800 and the income earned on it is $200. If your distribution is $1,000, $900 is from the excess deferral and $100 is from the income.

If you do not take out the excess amount, you may leave it in the plan. However, you must include the excess amount in your gross income for the tax year in which the amount was deferred. You cannot treat the excess amount as an investment in the contract (tax-free return of cost) when you figure the taxable amount of any future benefits or distributions. Thus, an excess deferral left in the plan would be taxed twice, once when contributed and again when distributed.

Exclusion from Gross Income

Generally, if you otherwise qualify, you can exclude from gross income your employer's contributions to a tax-sheltered annuity (TSA) to the extent that the contributions (including elective deferrals) do not exceed any of the following:

- The ***exclusion allowance*** for your tax year,
- The ***annual employer contribution limit*** for the ***limitation year*** ending with or within your tax year, or
- The ***limit on elective deferrals*** for the tax year.

For purposes of applying these rules, your employer's contributions do not include a rollover contribution from another TSA or an individual retirement arrangement (IRA).

Annual employer contribution limits. For the following limits, TSA programs are treated as defined contribution plans (described in *Limit on Employer Contributions,* later).

The general rule is that annual employer contributions for the limitation year cannot be more than the lesser of:

- $30,000, or
- 25% of the employee's compensation for the year.

See *Limit on Employer Contributions,* later, for a detailed discussion.

If contributions exceed these limits, treat the excess as amounts previously excludable in figuring your exclusion allowance for future years. (See *Amounts Previously Excludable,* later.) This treatment applies to the excess even though you included it in gross income in the year contributed.

The Exclusion Allowance

The exclusion allowance is the amount of employer contributions (including elective deferrals) to your tax-sheltered annuity (TSA) that you can exclude from income. You pay tax on them when you receive a distribution from the TSA.

More than one TSA. If, during any tax year, you have two or more TSA contracts, custodial accounts, or retirement income accounts, maintained by your employer, figure only one exclusion allowance for the TSAs because you must consider them as one TSA. However, if you have TSAs with more than one employer, you must figure a separate exclusion allowance for each employer (see *More than one employer,* later).

How to figure. You determine the exclusion allowance at the end of your tax year as follows:

1)	20%	20%
2)	**Includible compensation for most recent one-year period of service**	$
3)	**Years of service**	
4)	(1) × (2) × (3)	$
5)	Minus: **Amounts previously excludable**	
6)	Exclusion allowance (before reduction for any excess contributions)	$

The terms emphasized here are defined later in detail.

Reduction of the exclusion allowance. You must reduce your exclusion allowance by the amount that your employer's contributions (for tax years beginning after January 24, 1980) were more than the limit on employer contributions for those years. (See *Contributions in excess of employer limit* under *Limit on Employer Contributions,* later.) For future years, treat the excess as though it were an amount previously excludable.

Example. At the end of 1995, you had completed 3 years of service with your employer. Your salary for 1995 was $20,000 after being reduced under a revocable salary reduction agreement by $2,400 to finance your employer's contributions toward an annuity contract. Your employer's contributions for the year totaled $2,400, $100 of which was for current term life insurance protection.

In previous years, your employer's contributions to the regular retirement plan totaled $7,200, all of which you properly excluded from gross income. You determine your exclusion allowance and the amount includible in gross income for 1995 as follows:

Step 1—Limit on Employer Contributions

1)	Lesser of $30,000 or 25% of employee's compensation (25% × $20,000 = $5,000)		$ 5,000

Step 2—Contributions in Excess of Employer Limit

2)	1995 employer contribution for purchase of tax-sheltered annuity	$2,400	
3)	Minus: Portion of line 2, if any, representing cost of term life insurance that is includible in gross income	100	
4)	Balance of contributions applied to purchase of tax-sheltered annuity contract		$ 2,300
5)	Minus: Limit on employer contributions (line 1)		5,000
6)	Excess (if any)		$ –0–

Step 3—Exclusion Allowance

7)	20%	20%
8)	Includible compensation for most recent one-year period of service	$20,000
9)	Years of service	3
10)	(7) × (8) × (9)	$12,000
11)	Minus: Amounts previously excludable	7,200
12)	Exclusion allowance	$ 4,800

Step 4—Amount Excludable From Gross Income

13)	a) Employer contribution [line 4]	$2,300
	b) Limit on employer contributions [line 1]	$5,000
	c) Exclusion allowance [line 12]	$4,800
	d) Limit on elective deferrals	$9,500
14)	Amount excludable from gross income [least of 13(a), (b), (c), or (d)]	$ 2,300

Step 5—Amount Includible in Gross Income

15)	Employer contribution [line 4]	$ 2,300
16)	Minus: Amount excludable [line 14]	2,300
17)	Amount includible in gross income	$ –0–

WORKSHEETS 1 THROUGH 6 at the end of this publication will help you figure the amount of employer contributions that you can exclude from gross income and the amount you must include.

Catch-up election for certain employees. Certain employees can elect to figure the exclusion allowance under an alternate rule called the ***Overall Limit*** (explained under *Catch-up Election for Certain Employees*, later). Only employees of educational organizations, hospitals, home health service agencies, health and welfare service agencies, churches, and certain church-related organizations can make the election.

Employer must remain qualified. The exclusion allowance applies only to those contributions made while your employer was a qualified employer. If, for example, your employer loses tax-exempt status and is no longer qualified, your exclusion allowance will not apply to the employer's contributions made after losing the exemption.

More than one employer. If more than one qualified employer contributes to a TSA for you, you must figure a separate exclusion allowance for each qualified employer. Do not include ***amounts contributed, compensation,*** or ***years of service*** for one qualified employer in the computation for another qualified employer. Special rules apply to church employees, as discussed next.

Special rule for church employees. For figuring your exclusion allowance, treat all of your years of service with related church organizations as years of service with one employer. Therefore, if during your church career you transfer from one organization to another within that church or to an associated organization, treat all this service as service with a single employer. When these organizations make contributions to your annuity contracts, treat them as made by the same employer.

A church employee includes anyone who is an employee of a church or a convention or association of churches. This includes an employee of a tax-exempt organization controlled by or associated with a church or a convention or association of churches.

Minimum exclusion allowance for church employees. If you are a church employee and your adjusted gross income (figured without regard to community property laws) is not more than $17,000, you are entitled to exclude from your gross income a certain minimum amount called a minimum exclusion allowance. The minimum is your exclusion allowance figured as explained earlier, but not less than the smaller of:

$3,000, or

Your ***includible compensation*** (defined later).

If you are a foreign missionary during the tax year, your includible compensation includes contributions by the church during the year toward your tax-sheltered annuity.

You are a foreign missionary if your principal duties are spreading religious doctrine, or performing sacerdotal functions or humanitarian good works for the church outside the United States.

Includible Compensation

As a first step in figuring your exclusion allowance for a tax year, you must figure 20% of your includible compensation. Generally, your includible compensation is the salary from your employer—who made contributions to the tax-sheltered annuity (TSA)—that is:

Earned during your most recent period that may be counted as one-year of service, and

Includible in your gross income.

However, you should examine the following exceptions and definitions.

Special rules for determining includible compensation. Do not count compensation earned while your employer was not a qualified employer. However, your employer's status is immaterial when you actually receive the compensation.

Contributions by your employer for a tax-sheltered annuity are not part of includible compensation. (However, see *If you are a foreign missionary,* earlier.) Contributions that are more than your exclusion allowance are not part of compensation for figuring your exclusion allowance, but they must be included in your gross income.

Example. After taking a reduction in salary to pay for your employer's contribution for an annuity during your first year of employment, you received a salary of $12,000. According to your agreement, $2,800 ($400 more than your exclusion allowance) is contributed for your annuity. Use $12,000 as includible compensation in figuring the exclusion allowance, even though you must include $12,400 in gross income.

Contributions to two retirement plans. Your employer can make contributions for you toward both a TSA contract and a ***qualified*** retirement plan (contributions that are excludable from your gross income). The contribution to the qualified retirement plan is also not part of includible compensation for figuring your exclusion allowance.

The ***cost of incidental life insurance*** provided under a TSA contract is not includible compensation even though this cost is taxable to you.

Compensation from other employers who either are not qualified or are not purchasing your TSA contract or compensation from other sources is not includible compensation. Only the compensation earned from the qualified employer purchasing your TSA contract can qualify as includible compensation. However, see *Special rule for church employees,* earlier.

Foreign earned income exclusion. Excludable foreign earned income is part of includible compensation.

Most recent one-year period of service. Your includible compensation is only the compensation earned during your most recent period of service that ends on or before the end of the tax year for which the exclusion allowance is being determined. The period must be a full year of service if the total time you worked for your employer equals at least one full year. A part-time employee or a full-time employee who works part of a year, discussed below, must combine earnings for fractional parts of a year until they equal a full year's earnings. Thus, your most recent period of service will include more than one tax year if you were a part-time employee or if you were a full-time employee who worked only part of a tax year and you worked for your employer at least one full year over a period of more than one tax year.

If you worked less than a full year for your employer by the end of a tax year for which you are figuring the exclusion allowance, consider the actual period of your employment as your most recent one-year period of service for figuring your includible compensation.

For example, if you became employed on October 1, 1995, your most recent one-year period of service for figuring your includible compensation for your 1995 exclusion allowance is the period from October 1 through December 31, 1995. If your annual salary is $20,000, your includible compensation would be $5,000 (1/4 of $20,000).

Earned in a prior tax year. Your includible compensation may include all or part of your compensation earned in a tax year before the one for which the exclusion allowance is being determined. What is important is when you perform the service, not when you actually receive the compensation or the tax year in which it is includible in your gross income.

For example, if you are figuring your exclusion allowance for your 1995 tax year, and you were employed half time by your employer for all of 1994 and 1995, your includible compensation will include the amounts earned in 1994 and 1995.

In figuring your includible compensation, you must first take into account the service you performed during the tax year for which the exclusion allowance is being determined. Therefore, your most recent one-year period of service may not be the same as your employer's most recent annual work period.

Example. You are employed as a professor at a university and you use the calendar year as your tax year. You are employed on a full-time basis during the university's 1994–95 and 1995–96 academic years (October through May). In figuring your exclusion allowance for your 1995 tax year, your most recent one-year period of service consists of the service performed from January through May 1995 (which is part of the 1994–95 academic year), and the service performed from October through December 1995 (which is part of the 1995–96 academic year).

Note: Your most recent one-year period of service for determining includible compensation may not be the same period as your limitation year for determining the limit on employer contributions. See the discussion under *Limitation year,* later.

Full-time employee for a full year. If you are a full-time employee for the full year, your most recent one-year period of service generally will be your current tax year.

To determine whether you are employed full time, compare the amount of work you are required to do with that required of individuals holding the same position with the same employer, and who receive most of their compensation from that position. If your position with your employer is the only one of its kind with your employer, you cannot make this comparison. You should consider the same position with similar employers, or similar positions with your employer.

In measuring the amount of work required by a particular position, any method that reasonably and accurately reflects the amount of work can be used. For example, the fact that a full-time English professor at your school normally performs 16 hours of classroom teaching each week may be used as a measure of the amount of work required in the position.

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 you are a doctor employed by a hospital 12 months of the year, except for a one-month vacation, and the other doctors at the hospital work 11 months of the year with a one-month vacation, you will be considered employed for a full year. Similarly, if the usual annual work period at a university consists of the fall and spring semesters, and you teach at the university during these semesters, you will be considered as working a full year.

Part-time employee, or full-time employee working for part of a year. If you are a part-time employee, or a full-time employee who worked for part of a year, you are treated as having a fraction of a year of service for each year you were so employed. You must total these fractional periods of service to determine your most recent one-year period of service. You first take into account your service during the current tax year, then the next preceding tax year, and so forth, until your service equals one year of service.

Example. You are figuring your exclusion allowance for your 1995 tax year (which also is a calendar year). You worked full time one-fourth of a year for the last 10 years. Your most recent one-year period of service includes the service you performed in the period 1992 through 1995, figured as follows:

1995 fractional period of service	1/4
1994 fractional period of service	1/4
1993 fractional period of service	1/4
1992 fractional period of service	1/4
1 year of service equals	4/4

Full-time employee for part of a year. If you were a full-time employee for part of a year, the numerator of the fraction that represents your fractional year of service is the number of weeks (or months) that you were a full-time employee during that year. The denominator is the number of weeks (or months) considered to be the usual work period for your position.

Example. You are employed full time as an instructor by a university for the 1995 spring semester (which lasts from February through May). The academic year of the university is 8 months long, beginning in October and ending the following May. You are considered as having completed four-eighths of a year of service.

Part-time employee for a full year. If you are a part-time employee for a full year, the numerator of the fraction that represents your fractional year of service is the amount of work you are required to perform. The denominator is the amount of work normally required of individuals who hold the same position.

Example. You are a practicing physician teaching one course at a local medical school 3 hours a week for two semesters, and other faculty members at that medical school teach 9 hours a week for two semesters. You are considered to have completed three-ninths of a year of service.

Part-time employee for part of a year. If you are a part-time employee for part of a year, you determine the fraction that represents your fractional year of service by:

1) Determining a fractional year as if you were a full-time employee for part of a year,

2) Determining a fractional year as if you were a part-time employee for a full year, and

3) Multiplying the fractions in (1) and (2).

Example. You are an attorney and a specialist in federal tax law. In addition to your private practice, you teach tax law for 3 hours a week for one semester (the 4-month spring semester) at a nearby law school. Full-time instructors at the law school teach 12 hours a week for two semesters (or an 8-month academic year).

A fractional year of service determined as if you were a full-time employee for part of a year is one-half (the numerator being the period you worked, or 4 months, and the denominator being the usual work period, or 8 months).

A fractional year of service determined as if you were a part-time employee for a full year is three-twelfths (the numerator being the number of hours you are employed, and the denominator being the usual number of hours required for that position).

Your fractional year of service is $\frac{3}{24}$ ($\frac{1}{2} \times \frac{3}{12}$).

Years of Service

Your next step in figuring your exclusion allowance is to determine your years of service with the employer that contributes to a TSA on your behalf. Your years of service are the total number of years you worked for your employer determined as of the end of the tax year for which you are figuring an exclusion allowance. Your years of service cannot be less than one year (if your "most recent one-year period of service" is less than a year, your "years of service" is one year). The service need not be continuous. You cannot count service for any other employer. However, see *Special rule for church employees,* earlier.

Status of employer. Your years of service will only include periods that your employer was a ***qualified employer,*** as defined earlier.

Full-time employee for a full year. Your years of service will be the actual number of years you have worked for the employer that contributes to the tax-sheltered annuity on your behalf. See the discussions of *full-time employee for a full year* and *a full year of service,* earlier.

Part-time or full-time employee for part of a year. You must determine the fraction that represents your fractional year of service. These rules are the same as those for determining your *most recent one-year period of service,* discussed earlier.

Amounts Previously Excludable

The next step in determining your exclusion allowance is to subtract the amounts previously excludable from the result of multiplying 20% of includible compensation by your years of service.

Amounts previously excludable refers to the total of all contributions for annuities made for you by your employer to the TSA—but only contributions that were excludable from your gross income. This only applies to tax years before the one for which the current exclusion allowance is being determined. (After a few years, it may be possible that you will have no exclusion allowance, especially if your employer made large contributions.)

Amounts previously excludable are contributions in earlier years by your employer to:

A tax-sheltered annuity,

A qualified annuity plan or a qualified pension, profit-sharing, or stock bonus trust,

A qualified bond-purchase plan,

A retirement plan under which the contributions originally were excludable by you only because your rights to the contributions were forfeitable when made, and which also were excludable by you when your rights became nonforfeitable (this does not apply to contributions made after 1957 to purchase an annuity contract if your employer was an exempt organization when the contributions were made), or

An eligible deferred compensation plan (under Code section 457) of a state or local government or tax-exempt organization, even if maintained by a separate employer.

You must treat contributions to a state teachers retirement system made for you in earlier tax years, up to the amount that was excludable, as amounts previously excludable.

You must treat employer contributions in earlier years (beginning after January 24,1980) that were more than the limit as if they were amounts previously excludable. See *Limit on Employer Contributions,* later.

If you do not know the amount that an employer contributes to a plan on your behalf, you can determine your part of your employer's contributions by any method using recognized actuarial principles that are consistent with your employer's plan and the method used by your employer for funding the plan. You may also use the following formula.

Formula. The contributions your employer made for you as of the end of any tax year are the result of multiplying the following four items:

1) The projected annual amount of your pension (as of the end of the tax year) to be provided at normal retirement age from employer contributions, based on your plan in effect at that time, and assuming your continued employment with that employer at your then current salary rate,

2) The value from Table I based on the normal retirement age as defined in the plan,

3) The amount from Table II for the sum of —

   a) The number of years remaining from the end of the tax year to normal retirement age, plus

   b) The lesser of the number of years of service credited through the end of the tax year or the number of years that the plan has been in existence at that time, and

4) The lesser of the number of years of service credited through the end of the tax year or the number of years that the plan has been in existence at that time.

Table I

[Value at normal retirement ages of annuity of $1 per year payable in equal monthly installments during the life of the employee.]

[For tax years beginning after July 1, 1986.]

Ages	Value
40	11.49
41	11.40
42	11.31
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, divide the value from Table I by the appropriate figure as follows:

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	0.75

The term ***cash refund*** refers to a refund of accumulated employer contributions, not to a 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 tax years beginning after July 1, 1986.]

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

Example. Joe Blue, who was 29 at the end of 1995, has been employed by the Oak County school system since 1992. In 1992, Joe's employer contributed to a TSA program. Since 1992, Joe's employer has contributed to both the TSA program and a statewide retirement system that provides a straight-life annuity upon retirement. Joe is covered by both plans.

For 1995, Joe wishes to figure the ***amounts previously excludable*** under both plans so that he can figure the exclusion allowance for that year. His employer's contributions to the statewide retirement system were not allocated among the individual employees.

Joe's employer gives him the following information:

Employer contributions to the TSA that were excludable from gross income in prior years:

1992	$2,000
1993	2,400
1994	2,800

The projected annual amount of Joe's retirement system pension (as of the end of 1994 when Joe was 28) is $12,000. The pension begins at age 65 from his employer's contributions. This is based on 1994 plan provisions and assumes that Joe works for the same employer until age 65 at his 1994 salary. Normal retirement age is 65.

Joe figures the ***amounts previously excludable*** under the pension plan as follows:

A.	Projected annual amount of pension at normal retirement age (65)	$12,000
B.	Table I value at normal retirement age (65)	8.08
C.	Table II amount for the sum of:	
	1) Number of years from end of the preceding tax year (1994) to normal retirement age (65 minus 28)	37
	2) Plus: Lesser of years of plan existence or years of service	3
		40
	Table II amount for total of 40	.0039
D.	Lesser of years of plan existence or years of service	3

Joe multiplies A times B times C times D.

$12,000 × 8.08 × .0039 × 3 = $1,134.43

Joe then adds the amounts contributed to the tax-sheltered annuity plan in years prior to the 1995 tax year ($7,200) to determine the ***amounts previously excludable*** of $8,334.43.

Note: See *Contributions in excess of employer limit,* later.

Limit on Employer Contributions

Limits are placed on the contributions that can be made by an employer to tax-sheltered annuity (TSA) programs for each ***limitation year***. Every TSA is treated as a defined contribution plan for purposes of this limit (which is also called the ''general rule''). Under the general rule, an employer's contributions to an employee's account under a defined contribution plan should not be more than the lesser of:

1) $30,000 (or, if greater, 1/4 of the dollar limit for defined benefit plans), or
2) 25% of the employee's ***compensation*** for the year.

This limit generally applies instead of the exclusion allowance or the limit on elective deferrals (discussed earlier), if this limit is the smallest of the three limits. However, see *Catch-up Election for Certain Employees,* later.

Limitation year. Generally, your limitation year is the calendar year. However, you can elect to change to a different limitation year consisting of a period of 12 consecutive months by attaching a statement to your individual income tax return for the tax year you make the change. If you control an employer, your limitation year is the same as the limitation year of the employer. Control is defined in sections 414(b) and 414(c) (as modified by section 415(h)) of the Internal Revenue Code.

Contributions in excess of employer limit. If in earlier years your employer made annual contributions to a TSA for you that were more than the annual maximum permitted under the preceding limit, your ***exclusion allowance*** is reduced by the excess. This is done by including the excess in ***amounts previously excludable***, discussed earlier.

Include prior year excess contributions in amounts previously excludable only if the limit is exceeded for a tax year beginning after January 24, 1980. For future tax years, the exclusion allowance must be reduced by this excess contribution even though it was not excludable from your gross income in the tax year when it was made.

If you must combine a TSA with a qualified plan, and, as a result, the limit is exceeded, the excess is includible in your gross income for the tax year the excess contribution was made, and reduces your exclusion allowance for any future years in which you are a participant in a TSA program.

If you are a participant in both a TSA program and a qualified plan, see *Limit for Contributions to More Than One Program,* later.

WORKSHEET 2 at the end of this publication will help you figure the **Limit on Employer Contributions** and the amount you can exclude from gross income.

Compensation. Generally, for the 25% limit (item (2) at the beginning of this discussion), compensation includes:

- Wages, salaries, and fees for personal services with the employer maintaining the plan, even if excludable as foreign earned income,
- Certain taxable accident and health insurance payments,
- Moving expense payments or reimbursements paid by employer if such payments are not deductible by you, and
- The value of nonqualified stock options granted to you that are includible in your gross income in the year granted.

Generally, compensation does not include:

- Contributions toward a tax-sheltered annuity contract,
- Contributions toward a deferred compensation plan if, before applying the limit on employer contributions, the contributions are not taxable,
- Distributions from a deferred compensation plan,
- Proceeds from the disposition of stock acquired under a qualified stock option, and
- Certain other amounts that are excludable from your income, such as group term life insurance premiums that are not taxable.

More than one annuity contract. For each year you apply this limit, you must combine the contributions to all TSAs made on your behalf by your employer. This is done whether or not you elect one of the alternative limits discussed under *Catch-up Election for Certain Employees,* below. You may also have to combine contributions to qualified plans of the same employer or an employer that you control (for purposes of applying this limit). See *Limit for Contributions to More Than One Program,* later.

Catch-up Election for Certain Employees

If you are an employee of an educational organization, a hospital, a home health service agency, a health and welfare service agency, or a church or church-related organization that contributes to a tax-sheltered annuity (TSA) for you, you can make a ''catch-up'' election (see *Background,* later) to increase the limit on your employer's contributions by using one of three alternative limits. See also *Special Election for Church Employees,* later.

An ***educational organization*** and a ***church employee*** have been defined earlier. A ***home health service agency*** is a tax-exempt organization that has been determined by the Secretary of Health and Human Services to be a home health agency as defined in section 1861(o) of the Social Security Act. A ***church,*** for this purpose, includes a church, convention or association of churches, or a tax-exempt organization controlled by or associated with a church or a convention or association of churches.

Background. Employees of these organizations typically have a pattern of low employer contributions in the early stages of their careers and relatively high catch-up contributions later. Generally, the election to use one of the first two alternative limits listed below will permit you to exclude from gross income a larger amount of employer contributions than allowed under the general rule that limits the contributions to 25% of your compensation. If you elect to use the third alternative listed, you can disregard the ***exclusion allowance*** (discussed earlier) that would otherwise apply. The three alternative limits are:

Year of separation from service limit,

Any year limit, and

Overall limit.

You can make one of the three elections as explained later under *Making the Election.* You cannot make more than one election and, once one is made, it is irrevocable; however, you may always use the general limit in future years.

Excess contributions. If employer contributions are included in your income for a tax year because they exceed any of these alternative limits for that year, the excess reduces the amount of your exclusion allowance for future years, even though the excess has already been included in your income.

Year of Separation from Service Limit

For the limitation year (defined under *Limit on Employer Contributions,* earlier) that ends with or within the tax year you separate from the service of an educational organization, hospital, church, or other organization listed above, you can elect to substitute your ***exclusion allowance*** in place of the 25% of your compensation limit on employer contributions under the general rule. The $30,000 limit on employer contributions still applies. The limit on elective deferrals also still applies to the extent the contributions consist of elective deferrals.

Figure your exclusion allowance as explained earlier. For your years of service, count only the service you performed during the 10-year period ending on the date of separation. Do not use a period longer than 10 years even if the 10-year period is less than your actual number of years of service. Your amounts previously excludable are the amounts excludable during your years of service (limited to 10 years). All service for your employer performed within the 10-year period must be taken into account.

If your employer's annual contributions are more than the least of your modified exclusion allowance, $30,000, or the limit on elective deferrals, you must include the excess in gross income.

Example. Frank Green, who is president of a university, plans to retire on December 31, 1995, after 20 years of service. His compensation for 1995 is $50,000. During the 10-year period before the date of separation from service, Frank's employer contributed $20,000 of non-elective contributions to the TSA. The contributions were excludable from Frank's gross income. During all his years of service, his employer contributed a total of $30,000 that was excludable from Frank's gross income. For 1995, he agrees to have his employer contribute the maximum amount permitted under law to be excluded from gross income. He figures that amount under the *Year of Separation from Service Limit* as follows:

Step 1—Exclusion Allowance

1) 20%	20%
2) Includible compensation	$ 50,000
3) Years of service	20
4) Multiply (1) × (2) × (3)	$200,000
5) Minus: Amounts previously excludable	30,000
6) Exclusion allowance	$170,000

Step 2—Year of Separation from Service Limit

7) a) $30,000		$ 30,000
b) Exclusion allowance (modified)		
(i) 20%	20%	
(ii) Includible compensation	$ 50,000	
(iii) Years of service (Limited to 10 years)	10	
(iv) Multiply (i) × (ii) × (iii)	$100,000	
(v) Minus: Amounts previously excludable during 10-year period	20,000	
(vi) Exclusion allowance (modified)		$ 80,000
c) Limit on employer contributions [Lesser of (a) or (b) (vi)]		$ 30,000

If Frank elects this alternative limit, his employer could contribute $30,000 to a TSA during the year of separation from service without having a contribution in excess of this limit. In Step 1, Frank's exclusion allowance is $170,000. In Step 2, the maximum amount the employer may contribute for him is $30,000. If it were not for this election, the limit on employer contributions under the general rule would be $12,500 (25% × $50,000). The maximum amount he can exclude from income for 1995, however, is the least of:

- The limit on employer contributions ($30,000),
- The exclusion allowance ($170,000), or
- The limit on elective deferrals ($12,500).

The amount he can exclude is $12,500, his increased limit on elective deferrals (because he completed at least 15 years of service).

> ***WORKSHEET 3*** at the end of this publication will help you figure the **Year of Separation from Service Limit** and the amount you can exclude from gross income.

Any Year Limit

For any limitation year (defined earlier), you can substitute for the 25% of employee's compensation limit the ***least*** of the following:

1) $4,000, plus 25% of your includible compensation for the tax year in which the limitation year ends;

2) The exclusion allowance for the tax year in which the limitation year ends; or

3) $15,000.

The $15,000 maximum limit supersedes the $30,000 limit if you elect this limit.

If your employer's annual contributions are more than the least of your *Any Year Limit,* exclusion allowance, or the limit on elective deferrals (to the extent the contributions are elective deferrals), you must include the excess in your gross income.

Example. Bill Black is a principal with the Maple County school system. In 1995, his 17th year of service, Bill's salary is $29,000 without reduction for an amount under a salary reduction agreement. Bill's employer had contributed $34,400 to the tax-sheltered annuity program in earlier years, and all the contributions were excluded from Bill's income. Bill and his employer agree to a salary reduction of $9,000 that may be excluded from Bill's gross income. To find the maximum employer contribution allowed, Bill figured the *Any Year Limit* as follows:

Step 1—Exclusion Allowance

1) 20%	20%
2) Includible compensation	$20,000
3) Years of service	17
4) Multiply (1) × (2) × (3)	$68,000
5) Minus: Amounts previously excludable	34,400
6) Exclusion allowance	$33,600

Step 2—Any Year Limit

7) a) $4,000 plus 25% of includible compensation $4,000 + (25% × $20,000)	$ 9,000
b) Exclusion allowance (from Line (6))	$33,600
c) $15,000	$15,000
d) Least of (a), (b), or (c)	$ 9,000

Under this alternative limit, Bill's employer can contribute $9,000 to the annuity program and Bill can exclude that amount because it is also within the limit on elective deferrals. In Step 1, the exclusion allowance is $33,600; in Step 2, the maximum amount the employer can contribute on Bill's behalf is $9,000. Since this is less than the amount in Step 1, and within the limit on elective deferrals, $9,000 is the amount that can be excluded from gross income.

If it were not for this alternative limit, the maximum amount Bill's employer could contribute under the general rule would be $5,000 (25% × $20,000).

> ***WORKSHEET 4*** at the end of this publication will help you figure the **Any Year Limit** and the amount you can exclude from gross income.

Overall Limit

You can elect to have the limit on your employer's contributions and your exclusion allowance be equal to the lesser of $30,000 or 25% of compensation (see *Compensation under Limit on Employer Contributions,* earlier) for the limitation year ending in the tax year. Under this election, you disregard the computation of the exclusion allowance discussed under *The Exclusion Allowance,* earlier.

Include in your gross income any contribution that is more than the least of $30,000, 25% of compensation, or the elective deferral limit, if if applies.

If you elect the *Overall Limit,* you must combine contributions to the tax-sheltered annuity program with your employer's contributions to a qualified plan to determine whether the limits on employer contributions have been exceeded. See *Limit for Contributions to More Than One Program,* later.

Example. Mary White is employed as a nurse with Apple City General Hospital. In her 11th year of service, she agrees to have her employer contribute additional amounts to her tax-sheltered annuity program for catch-up contributions.

Her compensation for 1995 is $25,000. She figures the limit on contributions (and the amount considered the exclusion allowance) to be $6,250, using the *Overall Limit* election as follows:

1) Maximum limit on employer contributions	$30,000
2) 25% of compensation (25% × $25,000)	$ 6,250
3) Limit on employer contributions and exclusion allowance—(lesser of (1) or (2))	$ 6,250

> ***WORKSHEET 5*** at the end of this publication will help you figure the **Overall Limit** and the amount you can exclude from gross income.

Examples of Catch-up Elections

The following examples show how you can use the three alternative limits just discussed to maximize the amount of employer contributions to a tax-sheltered annuity (TSA) that you can exclude from income.

Example 1. Eli Green was an employee of Maple Hospital, a tax-exempt charitable organization, for the entire 1995 calendar year. His employer's contributions to a TSA for him are not subject to the elective deferral limit. Eli has a salary of $30,000 for the year. He has 4 years of service with his employer as of December 31, 1995. During Eli's prior service with Maple Hospital, his employer had contributed $12,000 on Eli's behalf to a TSA, and Eli excluded the amount from gross income in earlier years. Thus, for 1995, Eli's exclusion allowance is $12,000, figured as follows:

1) 20%	20%
2) Includible compensation	$30,000
3) Years of service	4
4) (1) × (2) × (3)	$24,000
5) Minus: Amounts previously excludable	12,000
6) Exclusion allowance	$12,000

The limit under the general rule for 1995 is the lesser of $30,000 or $7,500 (25% × $30,000).

Without the catch-up elections provided for certain employees, $7,500 would be the maximum contribution Maple Hospital could make for TSAs on behalf of Eli for 1995 without increasing Eli's gross income for that year.

Since Eli is an employee of a hospital, he can elect one of the catch-up limits. Eli can elect either the *Any Year Limit* or the *Overall Limit.* He cannot elect the *Year of Separation from Service Limit* since he does not separate from service in 1995.

If Eli elects the *Any Year Limit,* Maple Hospital could contribute $11,500 on his behalf for 1995 to a TSA, figured as follows:

1) $4,000, plus 25% of includible compensation	$11,500
2) Exclusion allowance	$12,000
3) $15,000	$15,000
4) Maximum contribution [least of (1), (2), or (3)]	$11,500

If Eli elects the *Overall Limit,* Maple Hospital could contribute only a maximum of $7,500 without increasing Eli's gross income for the year figured as follows:

1) $30,000	$30,000
2) 25% of compensation	$ 7,500
3) Maximum contributions [lesser of (1) or (2)]	$ 7,500

Example 2. Assume the same facts as in Example 1, except that Maple Hospital contributed $18,000 on Eli's behalf in earlier years to the TSA. The contributions were excludable from his gross income. Thus, for 1995, Eli's exclusion allowance is $6,000 figured as follows:

1) 20%	20%
2) Includible compensation	$30,000
3) Years of service	4
4) (1) × (2) × (3)	$24,000
5) Minus: Amounts previously excludable	18,000
6) Exclusion allowance	$ 6,000

The limit under the general rule for 1995 is the lesser of $30,000 or $7,500 (25% × $30,000).

Without the catch-up elections, $6,000 would be the maximum amount Maple Hospital could contribute on Eli's behalf for TSAs without increasing Eli's gross income. However, if Eli elects the *Overall Limit,* Maple Hospital could contribute up to $7,500 without increasing Eli's gross income for 1995.

Example 3. Bob White, a teacher, is employed by Elm School, a tax-exempt educational organization. Bob has a salary of $24,000 for 1995.

Bob has 20 years of service as of May 30, 1995, the date he separates from the service of Elm School. During Bob's service with Elm School before tax year 1995, Elm School had contributed elective deferrals of $68,000 toward the purchase of TSAs on behalf of Bob. The amount was excludable from his gross income for the prior years. Of this amount, $38,000 was contributed and excluded during the 10-year period ending on May 30, 1995. For the tax year 1995, Bob's exclusion allowance is $28,000 determined as follows:

1) 20%	20%
2) Includible compensation	$24,000
3) Years of service	20
4) (1)× (2)× (3)	$96,000
5) Minus: Amounts previously excludable	68,000
6) Exclusion allowance	$28,000

Without the catch-up elections, $6,000—the least of the exclusion allowance ($28,000), 25% of compensation ($6,000), or the increased elective deferral limit (12,500 because he completed at least 15 years of service)—would be the maximum excludable contribution Elm School could make to a TSA on Bob's behalf for 1995.

However, because Bob was an employee of an educational organization and has separated from service, he can elect any of the three catch-up elections.

If Bob elects the *Year of Separation from Service Limit* for 1995, Elm School could contribute up to $10,000 for that year without increasing Bob's gross income, figured as follows:

1) 20%	20%
2) Includible compensation	$24,000
3) Years of service (not to exceed 10)	10
4) (1)× (2)× (3)	$48,000
5) Minus: Amounts previously excludable	38,000
6) Maximum contribution under *Year of Separation from Service Limit*	$10,000

If Bob elects the *Any Year Limit* for 1995, Elm School could contribute up to $10,000, which is the least of the following:

1) $4,000, plus 25% of includible compensation	$10,000
2) Exclusion allowance	$28,000
3) $15,000	$15,000

If Bob elects the *Overall Limit* for 1995, Elm School could contribute up to $6,000, which is the lesser of the following:

1) $30,000	$30,000
2) 25% of compensation	$ 6,000

Special Election for Church Employees

If you are a church employee and the *minimum exclusion allowance* (described earlier under *The Exclusion Allowance*) applies, your employer can make contributions for the year up to the minimum exclusion allowance even though the contributions would otherwise be more than the limit on employer contributions to a defined contribution plan.

In addition to the ''any year'' or ''overall'' limit, you can make a special election that allows your employer to contribute up to $10,000 for the year, even if this is more than 25% of your compensation for the year. The total contributions over your lifetime under this election cannot be more than $40,000. In this situation, the exclusion allowance limit still applies, unless you also elect the *Overall Limit,* described earlier. If the contributions are elective deferrals, they are also subject to the limit on elective deferrals.

You cannot make this special election for a tax year in which you use the *Year of Separation from Service Limit,* described earlier.

Making the Election

You make the election for one of the three alternative limits by figuring your tax using that limit. However, the election is treated as made only when ***needed*** to support the exclusion from gross income reflected on the income tax return.

Election is irrevocable. If you elect to use an alternative limit, you cannot change the election.

If you elect one of the alternative limits, you cannot elect to have any of the others apply for any future year for any TSA purchased for you by any employer. If you elect the *Any Year Limit* or the *Overall Limit,* it is the only alternative limit you can use for later years.

If you elect the *Year of Separation from Service Limit,* you cannot elect any alternative limit in any later year for any tax-sheltered annuity. You can use this limit only once.

Failure to pay estimated income tax. If you amend an earlier year's return to elect an alternative limit, and that limit increases your tax for that year, the difference in tax due to the use of the alternative limit is not treated as an underpayment of tax for the penalty for failure to pay estimated income tax.

Limit for Contributions to More Than One Program

Special rules apply in determining the limit on employer contributions for you to a tax-sheltered annuity (TSA) program if you also are covered by a qualified plan.

Combining contributions. Generally, contributions to TSA programs must be combined with contributions to qualified plans of all corporations, partnerships, and sole proprietorships in which you have ***more than 50% control*** to determine whether the limits have been exceeded.

If you elect the *Overall Limit,* discussed earlier, you must combine contributions whether or not you have this control.

Example 1. You have an HR–10 plan (sometimes called a Keogh plan) for a sole proprietorship business, and you are also a participant in a charity's TSA program. You must combine contributions under the two plans to determine whether the limit on employer contributions is satisfied.

Example 2. You are employed by an educational organization that provides a TSA program. You are also a shareholder owning more than 50% of a professional corporation. You must combine any qualified plan of the professional corporation with the TSA.

Excess contributions. If you combine the TSA contract and a qualified plan, the limit on employer contributions may be exceeded. The excess is includible in your gross income for the tax year the excess contribution was made, and it reduces your exclusion allowance for all future years.

Other Rules

The following additional rules generally relate to contributions to your tax-sheltered annuity (TSA), and to other transactions affecting your annuity before you retire or receive annuity benefits.

Voluntary Employee Contributions

For tax years beginning after 1986, you cannot deduct voluntary employee contributions you make to your TSA.

However, there may be amounts in your TSA that are from deductible voluntary employee contributions you made in earlier years. If these amounts are distributed to you, you must include them in gross income unless you roll them over into an IRA or into another TSA.

Tax on Excess Contributions to a Custodial Account

You are liable for a 6% excise tax on contributions in excess of the exclusion allowance or the limit on employer contributions made under a TSA plan investing in mutual fund shares through a custodial account. The tax ***does not apply*** to excess contributions made to pay premiums on an annuity contract.

You cannot deduct the tax. It is due each year until the year the excess contribution is corrected. Excess contributions may be corrected by contributing less in future years. Simply, if there is an excess contribution in 1995 and no corrective action is taken for that year, you are liable for the tax for 1995 and later years (in addition to any tax due because of additional excess contributions in a later year).

How to figure tax. You figure the excess contributions tax for the current year as follows:

1) Total amount contributed for current year, minus rollovers	______
2) Lesser of exclusion allowance or annual limit on employer's contribution	______
3) Current year excess contributions (line 1 minus line 2, but not less than zero)	______
4) Preceding year excess contributions not previously eliminated. If zero, proceed to line 8	______
5) Contribution credit (if line 2 is more than line 1, enter the excess, otherwise enter zero)	______
6) Total of all prior years' distributions out of the account included in your gross income (not including amounts received as an annuity) and not previously used to reduce excess contributions	______
7) Adjusted preceding year's excess contributions (line 4 minus the total of lines 5 and 6)	______
8) Taxable excess contributions (line 3 plus line 7)	______
9) Excess contributions tax—Enter the lesser of 6% of line 8 or 6% of the value of your account as of the last day of the year	______

Reporting requirement. You must file Form 5330, *Return of Excise Taxes Related to Employee Benefit Plans,* if there has been an excess contribution to a ***custodial account*** and that excess has not been corrected in any year.

When to file. File Form 5330 by July 31 following the close of your tax year. You may be granted an extension (not to exceed 6 months) by filing Form 5558, *Application for Extension of Time To File Certain Employee Plan Returns,* early enough to give IRS time to consider and act on it before the due date of Form 5330.

Where to file. You should file Form 5330 with the Internal Revenue Service Center where you normally file your income tax return.

Cost of Insurance Protection

If your annuity contract provides you with incidental life insurance protection, you must include in your income each year the one-year cost of the life insurance premium. This cost should be included with salaries and wages on Form W–2.

Your current life insurance protection under an ordinary retirement income life insurance policy is the amount payable upon your death minus the cash value of the contract at the end of the year.

Example. Your new contract provides that your beneficiary will receive $10,000 if you should die anytime before retirement, and your cash value in the contract at the end of the first year is zero. Your current life insurance protection for the first year is $10,000 ($10,000 minus 0).

The one-year cost of the protection can be figured by using the following table. The premium rate is determined according to your age on your birthday nearest the beginning of the policy year.

If the current published premium rates per $1,000 of insurance protection charged by an insurer for individual one-year term life insurance premiums available to all standard risks are lower than those in the following table, you can use the lower rates for figuring the cost of insurance in connection with individual policies issued by the same insurer.

Uniform One-Year Term Premiums for $1,000 Life Insurance Protection

(Based on Table 38, U.S. Life Table and Actuarial Table (U.S. Government Printing Office, Washington, D.C.—1946), and 2½% interest.)

Age	Premium	Age	Premium
15	$1.27	49	$ 8.53
16	1.38	50	9.22
17	1.48	51	9.97
18	1.52	52	10.79
19	1.56	53	11.69
20	1.61	54	12.67
21	1.67	55	13.74
22	1.73	56	14.91
23	1.79	57	16.18
24	1.86	58	17.56
25	1.93	59	19.08
26	2.02	60	20.73
27	2.11	61	22.53
28	2.20	62	24.50
29	2.31	63	26.63
30	2.43	64	28.98
31	2.57	65	31.51
32	2.70	66	34.28
33	2.86	67	37.31
34	3.02	68	40.59
35	3.21	69	44.17
36	3.41	70	48.06
37	3.63	71	52.29
38	3.87	72	56.89
39	4.14	73	61.89
40	4.42	74	67.33
41	4.73	75	73.23
42	5.07	76	79.63
43	5.44	77	86.57
44	5.85	78	94.09
45	6.30	79	102.23
46	6.78	80	111.04
47	7.32	81	120.57
48	7.89		

Example. Lynn Green and her employer enter into a tax-sheltered annuity purchase agreement that will provide her with a $500 a month annuity upon retirement at age 65. The agreement also provides that if she should die before retirement, her beneficiary will receive the greater of $20,000 or the cash surrender value in the retirement income life insurance contract.

Since the cash surrender value at the end of the first year is zero, her net insurance is $20,000 ($20,000 minus 0). Her age on the nearest birthday is 44. Using the preceding table, she determines that her one-year term premium cost for $1,000 of insurance is $5.85. Thus, she must include in gross income $117.00 ($5.85 × 20) as the premium for her net insurance coverage of $20,000.

Lynn's cash value in the contract at the end of the 2nd year is $1,000. Thus, her life insurance coverage is $19,000 ($20,000 minus $1,000). Since the one-year term cost rate per $1,000 for age 45 in the 2nd year is $6.30, the amount to be included in income is $119.70 ($6.30 × 19).

Federal Insurance Contributions Act (FICA)

The contributions toward the tax-sheltered annuity (TSA) under a salary reduction agreement are considered wages for the FICA (social security and Medicare) tax. The employer must take into account the entire amount of these contributions for FICA tax purposes, whether they are wholly or partially excludable for income tax purposes. Moreover, these wages are credited to the employee's social security account for benefit purposes. However, if the employer makes a contribution to purchase an annuity, which is not under a salary reduction agreement, that amount is not considered wages for social security tax purposes.

A church or church-related organization may have chosen, for religious reasons, to have its employees be exempt from the FICA tax on all their earnings from that employment, including any TSA contributions. If this choice is in effect, the wages from church employment are generally subject to the self-employment tax (SECA) discussed next.

Self-Employment Contributions Act (SECA)

Generally, a person who renders services to a church as a minister is treated as a self-employed individual for the social security and Medicare self-employment tax, even though the minister may be an employee for other tax purposes. For social security and Medicare tax purposes (assuming the minister does not elect to be exempt from social security), some items of income excludable from the minister's gross income are not taken into account in determining the net earnings from self employment. Contributions for the minister toward a tax-sheltered annuity (TSA) contract are not taken into account as net earnings from self employment to the extent the contributions are not more than the exclusion allowance or employer contribution limit.

If you are an employee of a church or church-related organization and you chose exemption from FICA tax, as mentioned above, you must include wages from that employment in net earnings from self employment. However, do not include TSA contributions in figuring self-employment tax. The self-employment tax on wages from church employment is figured under special rules. See Schedule SE (Form 1040) and its instructions.

For information on FICA and SECA taxes, get Publication 517, *Social Security and Other Information for Members of the Clergy and Religious Workers*.

Reporting by Employer

If you participate in a tax-sheltered annuity (TSA) plan, your employer must report this participation by checking the ''Pension plan'' box on the Form W–2, *Wage and Tax Statement,* given to you and the IRS after the end of the year. If you have an individual retirement arrangement (IRA) and you or your spouse participate in a pension plan, the deduction for your IRA contributions may be reduced or eliminated. For information on IRAs, get Publication 590, *Individual Retirement Arrangements (IRAs).*

Also, your employer must report in box 13 of your Form W–2 your ***total*** elective deferrals, including any excess contributions to a TSA.

Employers and plan administrators must report contributions in excess of the limits that apply. Form 1099–R includes boxes for reporting ''gross'' and ''taxable'' amounts of total distributions.

Income Tax Withholding by Employer

Your employer's contributions to your tax-sheltered annuity, to the extent excludable from your gross income, are not subject to income tax withholding. However, any amount contributed to the plan in excess of the applicable limits, or used to purchase current life insurance protection, is subject to withholding.

Taxability to Employee of Excess Contributions

If your employer makes contributions to a tax-sheltered annuity contract for your benefit, the contributions are taxable to the extent they are more than the amount excludable from gross income (see *Exclusion from Gross Income,* earlier), but only to the extent the contributions under your TSA are or become vested. The amount excludable is the least of your exclusion allowance, the limit on employer contributions, or the limit on elective deferrals.

Your rights are ***substantially vested*** when they are transferable or are not subject to a substantial risk of forfeiture.

Your rights are ***transferable*** if you can transfer any interest in any property to any person other than the transferor, but only if your rights in the property are not subject to a substantial risk of forfeiture.

Property is transferable if you can sell, assign, or pledge your interest in it to anyone other than the transferor and if you do not have to give up the property or its value if the substantial risk of forfeiture materializes. Property is not transferable merely because you may designate a beneficiary to receive it in the event of your death.

A ***substantial risk of forfeiture*** exists when your rights in property that are transferred are directly or indirectly conditioned upon future performance (or refraining from performance) of substantial services by any person. A substantial risk of forfeiture also exists when rights in property depend on the occurrence of a condition related to the purpose of the transfer and the possibility of forfeiture is substantial if the condition is not satisfied.

Taxability of rights that change from nonvested to vested. The amount includible in your gross income, when your rights change from nonvested to substantially vested, is the value of the annuity contract that, on the date of change, is:

From contributions made by your employer before the date of change, and

More than the amount excludable from gross income.

The value of an annuity contract on the date your rights become substantially vested means the cash surrender value of the contract on that date.

Partial vesting. If, during your tax year, only part of the beneficial interest in an annuity contract becomes substantially vested, only a portion of the annuity contract value on the date of the change is includible in your gross income for the tax year.

The amount includible in your gross income is figured as follows:

1) Find the amount includible in gross income without regard to the exclusion allowance or limit on employer contributions if the ***entire*** beneficial interest in the annuity contract had changed to a substantially vested interest during the tax year.

2) Multiply the amount in (1) by the percent of your beneficial interest that became substantially vested during the tax year.

The resulting amount in (2) is taxable to the extent it is more than the amount excludable from gross income.

Gift Tax

If, by choosing or not choosing an election or option, you provide an annuity for your beneficiary at or after your death, you may have made a taxable gift for gift tax purposes equal to the value of the annuity.

Joint and survivor annuity. If the gift is an interest in a joint and survivor annuity where ***only*** you and your spouse have the right to receive payments, the gift will generally be treated as qualifying for the unlimited marital deduction.

More information. For information on the gift tax, see Publication 950, *Introduction to Estate and Gift Taxes.*

Distributions and Rollovers

In most cases, the payments you receive, or that are made available to you, under your tax-sheltered annuity contract are taxable in full as ordinary income. In general, the same tax rules apply to distributions from tax-sheltered annuities that apply to distributions from other retirement plans. These rules are explained in Publication 575, *Pension and Annuity Income (Including Simplified General Rule).*

Minimum Distributions

You must receive all, or at least a certain minimum, of your interest accruing after 1986 in the tax-sheltered annuity program by April 1 of the year immediately following the year in which you reach age $70\frac{1}{2}$. Check with your employer or plan administrator to find out whether this rule also applies to pre-87 accruals. If not, a minimum amount of these accruals must begin to be distributed no later than the end of the calendar year in which you attain age 75. For each year thereafter, the minimum distribution must be made by the last day of the year. If you do not receive the required minimum distribution, you are subject to a nondeductible 50% excise tax.

For more information on minimum distribution requirements, see Publication 575, *Pension and Annuity Income (Including Simplified General Rule).*

No Special 5– or 10–Year Tax Option

A distribution from a tax-sheltered annuity does **not** qualify as a lump-sum distribution. This means you cannot use the special 5– or 10–year tax option.

Transfer of Interest in Tax-Sheltered Annuity

If you transfer all or part of your interest from a tax-sheltered annuity contract or account to another tax-sheltered annuity contract or account, the transfer is tax free. However, this treatment applies only if the transferred interest is subject to the same or stricter distribution restrictions. This rule applies regardless of whether you are a current employee, a former employee, or a beneficiary of a former employee. Transfers that do not satisfy this rule are plan distributions.

Tax-free transfers for certain cash distributions. A tax-free transfer may also apply to a cash distribution for your annuity contract or account from an insurance company that is subject to a rehabilitation, conservatorship, insolvency, or similar state proceeding. To receive tax-free treatment, you must do all of the following:

1) Reinvest the cash in an annuity contract or account issued by another insurance company.

2) Withdraw all the cash to which you are entitled in full settlement of your contract

rights or the maximum permitted by the state.

3) Reinvest the cash distribution into another annuity contract or account issued by another insurance company or single custodial account not later than 60 days after you receive the cash distribution.
4) Assign all future distribution rights to the new contract or account for investment in that contract or account if you received an amount that is less than what you are entitled to because of state restrictions.
5) Reinvest in an annuity contract or account subject to the same or stricter distribution restrictions as the original contract.

In addition to the preceding requirements, you must provide the new insurer with a written statement containing the following information:

1) The gross amount of cash distributed under the old contract,
2) The amount of cash reinvested in the new contract, and
3) Your investment in the old contract on the date you receive your first cash distribution.

Also, you must attach the following items to your timely filed income tax return in the year you receive the first distribution of cash.

1) A copy of the statement you gave the new insurer.
2) A statement that includes:
   a) The words ''ELECTION UNDER REV. PROC. 92-44,''
   b) The name of the company that issued the new contract, and
   c) The new policy number.

Tax-Free Rollovers

You can generally roll over tax free all or any part of a distribution from a tax-sheltered annuity (TSA) plan to an IRA or another TSA plan. The most you can roll over is the amount that, except for the rollover, would be taxable. The rollover must be completed by the 60th day following the day on which you receive the distribution.

Nonqualifying distributions. Under these rules, you cannot roll over:

1) Minimum distributions (generally required to begin at age 70½),
2) Substantially equal payments over your life or life expectancy,
3) Substantially equal payments over the joint lives or life expectancies of you and your beneficiary, or
4) Substantially equal payments for a period of 10 years or more.

Direct rollovers for TSA distributions. You have the option of having your TSA plan make the rollover directly to the IRA or new plan. Before you receive a distribution, your plan will give you information on this. It is generally to your advantage to choose this option because your plan will not withhold tax on the distribution.

Withholding. If you ***receive*** a distribution that qualifies to be rolled over, the payer must withhold 20% of it for taxes (even if you plan to roll the distribution over). You can no longer choose to have no withholding unless you elect the direct rollover option.

Distribution received by you. If you receive a distribution that qualifies to be rolled over, you can roll over all or any part of the distribution. Generally, you will receive only 80% of the distribution because 20% must be withheld. If you roll over only the 80% you receive, you must pay tax on the 20% you did not roll over. You can replace the 20% that was withheld with other money within the 60-day period to make a 100% rollover.

Voluntary deductible contributions. For tax years 1982 through 1986, employees could make deductible contributions to a tax-sheltered annuity under the individual retirement arrangement (IRA) rules instead of deducting contributions to an IRA.

If you made voluntary deductible contributions to a tax-sheltered annuity under these IRA rules, the distribution of all or part of the accumulated deductible contributions may be rolled over assuming it otherwise qualifies as a distribution you can roll over. Accumulated deductible contributions are the deductible contributions plus income and gain allocable to the contributions, minus expenses and losses allocable to the contributions, and minus distributions from the contributions, income, or gain.

Excess employer contributions. The portion of a distribution from a TSA transferred to an individual retirement account (IRA) that was previously included in income as excess employer contributions is not an eligible rollover distribution. See *Limit on Employer Contributions,* earlier.

Its transfer does not affect the rollover treatment of the eligible portion of the transferred amounts. However, that amount is subject to the IRA contribution limits and may create an excess IRA contribution subject to a 6% excise tax (see chapter 7 of Publication 590, *Individual Retirement Arrangements (IRAs)).*

Qualified Domestic Relations Order. You may be able to roll over tax free all or any part of an eligible rollover distribution from a TSA plan that you receive under a qualified domestic relations order (QDRO). If you receive the interest in the TSA as an employee's spouse or former spouse under a QDRO, all of the rollover rules apply to you as if you were the employee. You can roll over your interest in the plan to an IRA or another TSA plan. For more information on the treatment of an interest received under a QDRO, see Publication 575, *Pension and Annuity Income (Including Simplified General Rule).*

Spouses of deceased employees. If you are the spouse of a deceased employee, you can roll over the qualifying distribution attributable to the employee. You can make the rollover only to an IRA, not to another TSA or qualified plan.

Second rollover. If you roll over a qualifying distribution to an IRA, you can, if certain conditions are satisfied, later roll the distribution into another TSA. For more information, see *IRA as a holding account* in Publication 590, *Individual Retirement Arrangements (IRAs).*

Frozen deposits. The 60-day period usually allowed for completing a rollover is extended for any time that the amount distributed is a ***frozen deposit*** in a financial institution. The 60-day period cannot end earlier than 10 days after the deposit ceases to be a frozen deposit.

A ***frozen deposit*** is any deposit that on any day during the 60-day period cannot be withdrawn because:

The financial institution is bankrupt or insolvent, or

The state where the institution is located has placed limits on withdrawals because one or more banks in the state are (or are about to be) bankrupt or insolvent.

Worksheets

You can use the following worksheets to figure the annual limits that apply to employer contributions to your tax-sheltered annuity (TSA).

Limits. The contribution limits that generally apply to your TSA are the:

1) Exclusion allowance (Worksheet 1),
2) Limit on employer contributions (Worksheet 2), and
3) Limit on elective deferrals (Worksheet 6).

The smallest of these limits is the maximum amount that may be contributed to your TSA for the year and excluded from your gross income.

To determine the amount of contributions that you can exclude from your gross income, you must complete Worksheet 2 (or Worksheet 3, 4, or 5 if you elect one of the alternative limits covered next).

Alternative limits. You may be able to use an alternative limit instead of the limit in 1) or 2) of the preceding list. The limit in 1) can be replaced with the limit in 2) by electing the *Overall Limit* (Worksheet 5). The limit in 2) can be figured in a different way by electing the *Year of Separation from Service Limit* (Worksheet 3) or the *Any Year Limit* (Worksheet 4). To make any of these elections, you must be an employee of an organization described under *Catch-up Election for Certain Employees,* earlier.

How to use worksheets. Since the smallest of the limits that apply to you is your limit for the year, first determine the amounts of these limits by completing the worksheets that apply to you.

Worksheets to complete. No more than three worksheets can apply to you. You must complete Worksheet 1 for your exclusion allowance. If elective deferrals were contributed to your TSA, also complete Worksheet 6. The third worksheet that can apply to you is among worksheets 2 through 5 —complete only the one that applies to you (each one includes steps for figuring the amount of contributions you can exclude from your income and any contributions you must include in income).

Worksheet 1—Computation of Exclusion Allowance

Step 1—Exclusion Allowance

1) 20%	20%
2) Includible compensation for most recent one-year period of service	$
3) Years of service	
4) (1) × (2) × (3)	$
5) Minus: Amounts previously excludable (including prior year excess contributions)	
6) Exclusion allowance	$

Worksheet 2—Limit on Employer Contributions

Step 1—Limit on Employer Contributions

1) Maximum ($30,000) or, if greater, 1/4 of the dollar limit for defined benefit plans [See *Limit on Employer Contributions*.]	$
2) 25% of compensation	$
3) Limit on employer contributions [lesser of (1) or (2)]	$

Step 2—Contributions in Excess of Employer Limit

4) Current year contribution by employer (excluding cost of life insurance)*	$
5) Minus: Limit on employer contributions (line 3)	
6) Excess (if any)	$

Step 3 —Amount Excludable from Gross Income

7) a) Employer contribution (line 4)	$
b) Limit on employer contributions (line 3)	$
c) Exclusion allowance (Worksheet 1, line 6)	$
d) Limit on elective deferrals (Worksheet 6, line 16)	$
8) Amount excludable from gross income [least of (a), (b), (c), or (d)]	$

Step 4—Amount Includible in Gross Income

9) Employer contribution (line 4)	$
10) Minus: Amount excludable (line 8)	
11) Amount includible in gross income	$

* The cost of life insurance is includible in gross income.

Worksheet 3—Year of Separation from Service Limit Election [1]

Step 1—Limit on Employer Contributions

1) Maximum [See *Limit on Employer Contributions.*] $ 30,000

2) Exclusion allowance (modified)

a) 20% 20%

b) Includible compensation $______

c) Years of service (limited to 10 years) ______

d) (a)× (b)× (c) $______

e) Minus: Amounts previously excludable during 10 years (including prior year excess contributions) ______

f) Exclusion allowance (modified) $______

3) Limit on employer contributions [lesser of (1) or (2)(f)] $______

Step 2—Contributions in Excess of Employer Limit

4) Current year contribution by employer (excluding cost of life insurance) [2] $______

5) Minus: Limit on employer contributions (line 3) ______

6) Excess (if any) $______

Step 3—Amount Excludable from Gross Income

7) a) Employer contribution (line 4) $______

b) Limit on employer contributions (line 3) $______

c) Exclusion allowance (Worksheet 1, line 6) $______

d) Limit on elective deferrals (Worksheet 6, line 16) $______

8) Amount excludable from gross income [least of (a), (b), (c), or (d)] $______

Step 4—Amount Includible in Gross Income

9) Employer contribution $______

10) Minus: Amount excludable (line 8) ______

11) Amount includible in gross income $______

[1] Election applies only to employees of certain organizations. See *Catch-up Election for Certain Employees.*
[2] The cost of life insurance is includible in gross income.

Worksheet 4—Any Year Limit Election [1]

Step 1—Limit on Employer Contributions

1)	$4,000 plus 25% of includible compensation		$
2)	Exclusion allowance		
a)	20%	20%	
b)	Includible compensation	$	
c)	Years of service		
d)	(a)× (b)× (c)	$	
e)	Minus: Amounts previously excludable (including prior year excess contributions)		
f)	Exclusion allowance		$
3)	Maximum		$ 15,000
4)	Limit on employer contributions [least of (1), (2)(f), or (3)]		$

Step 2—Contributions in Excess of Employer Limit

5)	Current year contribution by employer (excluding cost of life insurance) [2]	$
6)	Minus: Limit on employer contributions (line 4)	
7)	Excess (if any)	$

Step 3—Amount Excludable from Gross Income

8) a)	Employer contribution (line 5)	$	
b)	Limit on employer contributions (line 4)	$	
c)	Exclusion allowance (Worksheet 1, line 6)	$	
d)	Limit on elective deferrals (Worksheet 6, line 16)	$	
9)	Amount excludable from gross income [least of (a), (b), (c), or (d)]		$

Step 4—Amount Includible in Gross Income

10)	Employer contribution (line 5)	$
11)	Minus: Amount excludable (line 9)	
12)	Amount includible in gross income	$

[1] Election applies only to employees of certain organizations. See *Catch-up Election for Certain Employees.*
[2] The cost of life insurance is includible in gross income.

Worksheet 5—Overall Limit Election [1&2]

Step 1—Limit on Employer Contributions

1) Maximum [See *Limit on Employer Contributions*]	$ 30,000
2) 25% × compensation [See *Compensation*, earlier, under *Limit on Employer Contributions*.]	$
3) Limit on employer contributions [lesser of (1) or (2)]	$

Step 2—Contributions in Excess of Employer Limitation

4) Current year contribution by employer (excluding cost of life insurance)[3]	$
5) Minus: Limit on employer contributions (line 3)	
6) Excess (if any)	$

Step 3—Amount Excludable from Gross Income

7) a) Employer contribution (line 4)	$	
b) Limit on employer contributions (line 3)	$	
c) Limit on elective deferrals, (Worksheet 6, line 16)	$	
8) Amount excludable from gross income [least of (a), (b), or (c)]		$

Step 4—Amount Includible in Gross Income

9) Employer contribution (line 4)	$
10) Minus: Amount excludable (line 8)	
11) Amount includible in gross income	$

[1] Election applies only to employees of certain organizations. See *Catch-up Election for Certain Employees*.
[2] Limit on employer contributions is considered equal to the exclusion allowance.
[3] The cost of life insurance is includible in gross income.

Worksheet 6—Limit on Elective Deferrals

Step 1—Total Elective Deferrals

1) Contributions to tax-sheltered annuities $ ________

2) Contributions to cash or deferred arrangements (section 401(k) plans) or section 501(c)(18) plans ________

3) Elective contributions to salary reduction simplified employee pension (SEP) plans ________

4) Total deferrals for year (add lines (1), (2), and (3)) $ ________

Step 2—Increase in Limit for Long Service

Note: Skip this step if you do not have at least 15 years service with a qualifying organization (see *Increase for 15-year employees* under *Limit on Elective Deferrals*)

5) Number of years service with the qualifying organization ________

6) Multiply $5,000 by the number of years in (5) $ ________

7) Total elective deferrals for prior years made for you by the qualifying organization ________

8) Subtract line (7) from line (6) $ ________

9) Enter all increases in the limit for long service (as figured in this Step 2) for prior years $ ________

10) Subtract line (9) from $15,000 $ ________

11) Enter the smaller of line (8) or line (10), but not more than $3,000 $ ________

Step 3—Limit on Elective Deferrals

12) Enter $9,500 plus the amount from line (11) $ ________

13) Basic allowable amount (enter $9,240 for 1995) ________

14) Subtract line (13) from line (12) $ ________

15) Enter the smaller of line (1) or line (14) ________

16) Add lines (13) and (15). This is your limit on elective deferrals for the year $ ________

17) Excess elective deferrals—Subtract line (16) from line (4). Do not enter less than zero. Include this amount in your income for the year the excess deferrals were made (see *Treatment of excess deferrals* under *Limit on Elective Deferrals*) $ ________