

# Instructions for Form 4972

## Tax on Lump-Sum Distributions From Qualified Retirement Plans

Section references are to the Internal Revenue Code.

### General Instructions

#### Purpose of Form

Use Form 4972 if you received a qualified lump-sum distribution (defined below) in 1997 and wish to choose the 20% capital gain election and/or the 5- or 10-year tax option. These are special formulas used to figure a separate tax on the distribution.

You pay the tax **only once**, for the year you receive the distribution, not over the next 5 or 10 years. Once you choose your option and figure the separate tax, it is then added to the regular tax figured on your other income. Using these special formulas may result in a **smaller** tax than you would pay if you reported the taxable amount of the distribution as ordinary income.

#### Related Publications

**Pub. 575**, Pension and Annuity Income

**Pub. 721**, Tax Guide to U.S. Civil Service Retirement Benefits

**Pub. 939**, General Rule for Pensions and Annuities

#### What Is a Qualified Lump-Sum Distribution?

It is the distribution or payment in 1 tax year of a plan participant's entire balance from all of the employer's qualified plans of one kind (i.e., pension, profit-sharing, or stock bonus plans) in which the participant had funds. The participant's entire balance does not include deductible voluntary employee contributions or certain forfeited amounts.

In addition, the distribution must have been made after the participant reached age 59½.

If you received a qualifying distribution as a beneficiary after the participant's death, the participant must have reached age 59½ before his or her death (or been born before

1936) for you to use this form for that distribution.

#### Distributions to alternate payees.

If you are the spouse or former spouse of a plan participant who reached age 59½ by the date of the distribution (or was born before 1936) and you received a qualified lump-sum distribution as an alternate payee under a qualified domestic relations order, you can use Form 4972 to figure the tax on that income.

If the distribution is a qualified distribution and the participant was born before 1936, you can use Form 4972 to make the 20% capital gain election and choose either the 5- or 10-year tax option to figure your tax on the distribution.

If the participant was born after 1935 but was at least age 59½ when the distribution was made, you can choose the 5-year tax option to figure the tax on a qualified distribution.

See **How To Report the Distribution** below.

#### Distributions That Do Not Qualify for the 20% Capital Gain Election or for the 5- or 10-Year Tax Option

The following distributions are not qualified lump-sum distributions and **do not** qualify for the 20% capital gain election or the 5- or 10-year tax option:

• **1.** Any distribution that is partially rolled over to another qualified plan or an IRA.

• **2.** Any distribution if an earlier election to use either the 5- or 10-year tax option had been made after 1986 for the same plan participant.

• **3.** U.S. Retirement Plan Bonds distributed with the lump sum.

• **4.** Any distribution made during the first 5 tax years that the participant was in the plan, unless it was paid because the participant died.

• **5.** The current actuarial value of any annuity contract included in the

lump sum (the payer's statement should show this amount, which you use only to figure tax on the ordinary income part of the distribution).

• **6.** Any distribution to a 5% owner that is subject to penalties under section 72(m)(5)(A).

• **7.** A distribution from an IRA.

• **8.** A distribution from a tax-sheltered annuity (section 403(b) plan).

• **9.** A distribution of the redemption proceeds of bonds rolled over tax free to a qualified pension plan, etc., from a qualified bond purchase plan.

• **10.** A distribution from a qualified pension or annuity plan when the participant or his or her surviving spouse received an eligible rollover distribution from the same plan (or another plan of the employer required to be aggregated for the lump-sum distribution rules), and the proceeds of the previous distribution were rolled over tax free to an eligible retirement plan (including an IRA).

• **11.** A corrective distribution of excess deferrals, excess contributions, excess aggregate contributions, or excess annual additions.

• **12.** A lump-sum credit or payment from the Federal Civil Service Retirement System (or the Federal Employees Retirement System).

#### How To Report the Distribution

If you qualify to use Form 4972, attach it to Form 1040 (individuals) or Form 1041 (estates or trusts). The payer should have given you a Form 1099-R or other statement that shows the separate amounts to use in completing the form. The following choices are available.

**20% capital gain election.** If the plan participant was born before 1936 and there is an amount shown in Form 1099-R, box 3, you can use Part II of Form 4972. You are electing to apply a 20% tax rate to the capital gain portion. See **Capital Gain Election** on page 2.

**5- or 10-year tax option.** If the plan participant was born before 1936, you can use Part III to choose the 5- or 10-year tax option to figure your tax on the lump-sum distribution. You can choose either option whether or not you make the 20% capital gain election described earlier.

If the plan participant was born after 1935 but the distribution was made on or after the date the participant reached age 59½, you can choose the 5-year tax option to figure your tax on the lump-sum distribution. You cannot use either the 10-year tax option or the 20% capital gain election.

**Where to report.** Depending on which parts of Form 4972 you choose to use, report amounts from your Form 1099-R either directly on your tax return (Form 1040 or Form 1041) or on Form 4972.

- If you choose **not** to use **any** part of Form 4972, report the entire amount from Form 1099-R, box 1 (Gross distribution), on Form 1040, line 16a and the taxable amount on line 16b (or on Form 1041, line 8). If your pension or annuity is fully taxable, enter the amount from Form 1099-R, box 2a (Taxable amount), on Form 1040, line 16b; **do not** make an entry on line 16a.
- If you choose **not** to use Part III of Form 4972, but you do use Part II, report only the ordinary income part of the distribution on Form 1040, lines 16a and 16b (or on Form 1041, line 8). The ordinary income part of the distribution is the amount shown in Form 1099-R, box 2a, minus the amount shown in box 3 of that form.
- If you choose to use Part III of Form 4972, do not include any part of the distribution on Form 1040, lines 16a and 16b (or on Form 1041, line 8).

The entries in other boxes on Form 1099-R may also apply in completing Form 4972:

- Box 6 (Net unrealized appreciation in employer's securities). See **Net unrealized appreciation (NUA)** on this page for details on how to treat this amount.
- Box 8 (Other). Current actuarial value of an annuity.

If applicable, get the amount of Federal estate tax paid attributable to the taxable part of the lump-sum distribution from the administrator of the deceased's estate.

### How Often You Can Choose

After 1986, you may choose to use Form 4972 only once for each plan

participant. If you receive more than one lump-sum distribution for the same plan participant in 1 tax year, you must treat all those distributions in the same way. Combine them on a single Form 4972.

If you make an election as a beneficiary of a deceased participant, it does not affect any election you can make for qualified lump-sum distributions from your own plan. You can also make an election as the beneficiary of more than one qualifying person.

**Example.** Your mother and father died and each was born before 1936. Each had a qualified plan of which you are the beneficiary. You also received a qualified lump-sum distribution from your own plan and you were born before 1936. You may make an election for each of the distributions; one for yourself, one as your mother's beneficiary, and one as your father's. It does not matter if the distributions all occur in the same year or in different years. File a separate Form 4972 for each participant's distribution.

**Note:** *An earlier election on Form 4972 or Form 5544 for a distribution before 1987 does not prevent you from making an election for a distribution after 1986 for the same plan participant, provided the participant was under age 59½ at the time of the pre-1987 distribution.*

### When You Can Choose

You can file Form 4972 with either an original or an amended return. Generally, you have 3 years from the later of the due date of your tax return or the date you filed your return to choose to use any part of Form 4972.

### Capital Gain Election

If the plan participant was born before 1936 and the distribution includes a capital gain, you can either **(a)** make the 20% capital gain election in Part II of Form 4972, or **(b)** treat the capital gain as ordinary income.

Only the taxable amount of distributions resulting from pre-1974 participation qualifies for capital gain treatment. The capital gain amount should be shown in Form 1099-R, box 3. If there is an amount from Form 1099-R, box 6 (net unrealized appreciation (NUA)), part of it may also qualify for capital gain treatment. Use the NUA Worksheet on page 3 to figure the capital gain part of NUA if you make the election to include NUA in your taxable income.

You may elect to report the remaining balance of the distribution as ordinary income on Form 1040, line 16b (or Form 1041, line 8), or you may elect to figure the tax using the 5- or 10-year tax option. The remaining balance is the difference between Form 1099-R, box 3, and Form 1099-R, box 2a.

### Net unrealized appreciation (NUA).

Normally, the NUA in employer securities received as part of a lump-sum distribution is not taxable until the securities are sold. However, you can elect to include NUA in taxable income in the year received.

The total amount to report as NUA should be shown in Form 1099-R, box 6. Part of the amount in box 6 will qualify for capital gain treatment if there is an amount in Form 1099-R, box 3, and you elect to include the NUA in current income.

To figure the total amount subject to capital gain treatment including the NUA, complete the NUA Worksheet on page 3.

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## Specific Instructions

**Name of recipient of distribution and identifying number.** At the top of Form 4972, fill in the name and identifying number of the recipient of the distribution.

If you received more than one qualified distribution in 1997 for the same plan participant, add them and figure the tax on the total amount. If you received qualified distributions in 1997 for more than one participant, file a separate Form 4972 for the distributions of each participant.

If you and your spouse are filing a joint return and each has received a lump-sum distribution, complete and file a separate Form 4972 for each spouse's election, combine the tax, and include in the total on Form 1040, line 39.

If you are filing for a trust that shared the distribution only with other trusts, figure the tax on the total lump sum first. The trusts then share the tax in the same proportion that they shared the distribution.

**Multiple recipients of a lump-sum distribution.** If you shared a lump-sum distribution from a qualified retirement plan when not all recipients were trusts (a percentage will be shown in Form 1099-R, boxes 8 and/or 9a), figure your tax on Form 4972 as follows:

**NUA Worksheet** (keep for your records)

*Complete only if you make the capital gain election.*

- |  |          |
|--|----------|
| A. Enter the amount from Form 1099-R, box 3 . . . . .  | A. _____ |
| B. Enter the amount from Form 1099-R, box 2a . . . . .   | B. _____ |
| C. Divide line A by line B and enter the result as a decimal . . . . .   | C. _____ |
| D. Enter the amount from Form 1099-R, box 6 . . . . .  | D. _____ |
| E. Multiply line C by line D (NUA subject to capital gain treatment) . . . . .   | E. _____ |
| F. Subtract line E from line D (NUA that is ordinary income) . . . . .   | F. _____ |
| G. Add lines A and E (total part of distribution that can receive capital gain treatment). Enter the total here and on Form 4972, line 6 . . . . . | G. _____ |
- On the dotted line next to line 6, write " NUA " and the amount from line E above.

**Death Benefit Worksheet** (keep for your records)

- |   |          |
|---|----------|
| A. Enter the capital gain amount from Form 1099-R, box 3. If you elected to include NUA in taxable income, enter the amount from line G of the NUA Worksheet . . . . .  | A. _____ |
| B. Enter the taxable amount from Form 1099-R, box 2a. If you elected to include NUA in taxable income, add the amount from Form 1099-R, box 6, to the amount from Form 1099-R, box 2a, and enter the total here . . . . . | B. _____ |
| C. Divide line A by line B and enter the result as a decimal . . . . .  | C. _____ |
| D. Enter your share of the death benefit exclusion* . . . . .   | D. _____ |
| E. Multiply line D by line C . . . . .  | E. _____ |
| F. Subtract line E from line A. Enter the result here and on Form 4972, line 6 . . . . .  | F. _____ |

\*Applies only for participants who died before August 21, 1996. If there are multiple recipients of the distribution, the \$5,000 maximum death benefit exclusion must be allocated among the recipients in the same proportion that they share the distribution.

**Step 1.** Complete Form 4972, Parts I and II. If you make the 20% capital gain election in Part II and also elect to include NUA in taxable income, see **Net unrealized appreciation (NUA)** on page 2 to determine the amount of NUA that qualifies for capital gain treatment.

**Step 2.** Use this step **only** if you **do not elect to include NUA** in your taxable income or if you do not have NUA. If you elect to include NUA in taxable income, skip Step 2 and go to Step 3. (Box numbers used below are all from Form 1099-R.)

**ÿ1.** If you do not make the capital gain election, divide the amount shown in box 2a by your percentage of distribution shown in box 9a. Enter this amount on Form 4972, line 8.

**ÿ2.** If you make the capital gain election, subtract the amount in box 3 from the amount in box 2a. Divide the result by your percentage of distribution shown in box 9a. Enter the result on Form 4972, line 8.

**ÿ3.** Divide the amount shown in box 8 by the percentage shown in box 8. Enter the result on Form 4972, line 11.

**Step 3.** Use this step **only** if you **elect to include NUA** in your taxable income.

**ÿ1.** If you do not make the capital gain election, add the amount shown

in box 2a to the amount shown in box 6. Divide the result by your percentage of distribution shown in box 9a. Enter the result on Form 4972, line 8.

**ÿ2.** If you make the capital gain election, subtract the amount in box 3 from the amount in box 2a. Add to the result the amount from line F of your NUA Worksheet. Then divide the total by your percentage of distribution shown in box 9a. Enter the result on Form 4972, line 8.

**ÿ3.** Divide the amount shown in box 8 by the percentage shown in box 8. Enter the result on Form 4972, line 11.

**Step 4.** Complete Form 4972 through line 36.

**Step 5.** Complete the following worksheet to figure the entry for line 37:

- |  |       |
|--|-------|
| A. Compare lines 29 and 36 of Form 4972. Enter the <b>smaller</b> amount here.....   | _____ |
| B. Enter your percentage of distribution from Form 1099-R, box 9a .....  | _____ |
| C. Multiply line A by the percentage on line B. Enter the result here and on Form 4972, line 37. Also, write "MRD" on the dotted line next to the entry space..... | _____ |

**Part II**

See **Capital Gain Election** on page 2 before completing Part II.

**Line 6.** Leave this line blank if your distribution does not include a capital gain amount, **or** you do not make the 20% capital gain election. Go to Part III.

To make the 20% capital gain election but **not take a death benefit exclusion** (which is applicable only for participants who died before August 21, 1996; see the instructions for line 9), enter on line 6 the entire capital gain amount from Form 1099-R, box 3. However, if you elect to include NUA in your taxable income, use the NUA Worksheet on this page to figure the amount to enter.

To make the 20% capital gain election when you **are taking a death benefit exclusion** (for a participant who died before August 21, 1996), use the Death Benefit Worksheet on this page to figure the amount to enter on line 6.

The remaining allowable death benefit exclusion should be entered on line 9, if you choose the 5- or 10-year tax option.

**If any Federal estate tax was paid on the lump-sum distribution**, you must decrease the capital gain amount by the amount of estate tax applicable to it. To figure the amount, multiply the total Federal estate tax paid on the lump-sum distribution by the decimal from line C of the Death Benefit Worksheet. The result is the portion of the Federal estate tax applicable to the capital gain amount. Then use that result to reduce the amount in Form 1099-R, box 3, if you don't take the death benefit exclusion, or reduce line F of the Death Benefit Worksheet if you do. Enter the remaining capital gain on line 6. If you elected to include NUA in taxable income, subtract the portion of Federal estate tax applicable to the capital gain amount from the amount on line G of the NUA Worksheet. Enter the result on line 6. Enter the remainder of the Federal estate tax on line 18.

**Note:** *If you take the death benefit exclusion and Federal estate tax was paid on the capital gain amount, the capital gain amount must be reduced by both the above procedures to figure the correct entry for line 6.*

### Part III

**Line 8.** If the payer of the distribution left box 2a (Taxable amount) of Form 1099-R blank, you must first figure the taxable amount. For details on how to do this, see Pub. 575.

If you **made the 20% capital gain election**, enter only the ordinary income from Form 1099-R on this line. To figure this amount, subtract Form 1099-R, box 3, from Form 1099-R, box 2a. Enter the result on line 8. Add to that result the amount from line F of the NUA Worksheet if you included NUA capital gain in the 20% capital gain election.

If you **did not make the 20% capital gain election** and did not elect to include NUA in taxable income, enter the amount from Form 1099-R, box 2a. If you did not make the 20% capital gain election but did elect to include NUA in your taxable income, add the amount from Form 1099-R, box 2a, to the amount from Form 1099-R, box 6. Enter the total on line 8. On the dotted line next to line 8, write "NUA" and the amount of NUA included.

**Note:** *Community property laws do not apply in figuring tax on the amount you report on line 8.*

**Line 9.** If you received the distribution because of the plan participant's death, and the participant died before August 21, 1996, you may be able to exclude up to \$5,000 of the lump sum from your gross income. If there are multiple recipients of the distribution not all of whom are trusts, enter on line 9 the full remaining allowable death benefit exclusion (after the amount taken against the capital gain portion of the distribution by all recipients—see the instructions for line 6) without allocation among the recipients. (The exclusion is in effect allocated among the recipients through the computation under **Multiple recipients of a lump-sum distribution** on page 2.) This exclusion applies to the beneficiaries or estates of common-law employees, self-employed individuals, and shareholder-employees who owned more than 2% of the stock of an S corporation. Pub. 575 gives more information about the death benefit exclusion.

Enter the death benefit exclusion on line 9. But see the instructions for line 6 if you made a capital gain election.

**Line 18.** A beneficiary who receives a lump-sum distribution because of a plan participant's death must reduce the taxable part of the distribution by any Federal estate tax paid on the lump-sum distribution. Do this by entering on line 18 the Federal estate tax attributable to the lump-sum distribution. Also see the instructions for line 6.

**Line 20.** Decimals should be carried to five places and rounded to four places. Drop amounts 4 and under (.44454 becomes .4445). Round amounts 5 and over up to the next number (.44456 becomes .4446).

**Lines 24 and 27.** Use the following tax rate schedule to complete lines 24 and 27.

#### Tax Rate Schedule for the 5-Year Tax Option Lines 24 and 27

If the amount on line 23 or 26 is:		Enter on line 24 or 27:	
Over—	But not over—		Of the amount over—
\$—	\$24,650	----- 15%	\$—
24,650	59,750	\$3,697.50 + 28%	24,650
59,750	124,650	13,525.50 + 31%	59,750
124,650	271,050	33,644.50 + 36%	124,650
271,050	-----	86,348.50 + 39.6%	271,050

**Lines 31 and 34.** Use the following tax rate schedule to complete lines 31 and 34.

#### Tax Rate Schedule for the 10-Year Tax Option Lines 31 and 34

If the amount on line 30 or 33 is:		Enter on line 31 or 34:	
Over—	But not over—		Of the amount over—
\$—	\$1,190	----- 11%	\$—
1,190	2,270	\$130.90 + 12%	1,190
2,270	4,530	260.50 + 14%	2,270
4,530	6,690	576.90 + 15%	4,530
6,690	9,170	900.90 + 16%	6,690
9,170	11,440	1,297.70 + 18%	9,170
11,440	13,710	1,706.30 + 20%	11,440
13,710	17,160	2,160.30 + 23%	13,710
17,160	22,880	2,953.80 + 26%	17,160
22,880	28,600	4,441.00 + 30%	22,880
28,600	34,320	6,157.00 + 34%	28,600
34,320	42,300	8,101.80 + 38%	34,320
42,300	57,190	11,134.20 + 42%	42,300
57,190	85,790	17,388.00 + 48%	57,190
85,790	-----	31,116.00 + 50%	85,790

**Line 37.** By entering the smaller of the amounts on lines 29 and 36, you elect either the 5-year or the 10-year tax option, whichever results in the lower Federal tax. However, you may wish to elect the option that results in the higher Federal tax if that would be advantageous for combined Federal and state tax purposes. To do this, write "Higher tax option elected" on the dotted line to the left of the line 37 entry space.

#### Paperwork Reduction Act Notice.

We ask for the information on this form to carry out the Internal Revenue laws of the United States. You are required to give us the information. We need it to ensure that you are complying with these laws and to allow us to figure and collect the right amount of tax.

You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and return information are confidential, as required by section 6103.

The time needed to complete this form will vary depending on individual circumstances. The estimated average time is: **Recordkeeping**, 33 min.; **Learning about the law or the form**, 26 min.; **Preparing the form**, 1 hr., 19 min.; **Copying, assembling, and sending the form to the IRS**, 35 min.

If you have comments concerning the accuracy of these time estimates or suggestions for making this form simpler, we would be happy to hear from you. See the instructions for the tax return with which this form is filed.