

section 403(b) annuities and, thus, is not subject to the applicable law governing transfers of funds between section 403(b) annuities. In applying the provisions of §1.401(a)(31)-1, the payor of the eligible rollover distribution is treated as the plan administrator.

(b) *Mandatory withholding.* As in the case of an eligible rollover distribution from a qualified plan, if a distributee of an eligible rollover distribution from a section 403(b) annuity does not elect to have the eligible rollover distribution paid directly to an eligible retirement plan in a direct rollover, the eligible rollover distribution is subject to 20-percent income tax withholding imposed under section 3405(c). See §1.3405(c)-1 of this chapter for provisions regarding the withholding requirements relating to eligible rollover distributions.

Q-3: Is the payor of a section 403(b) annuity required to provide the distributee of an eligible rollover distribution with an explanation of the direct rollover option?

A-3: Yes. In order to ensure that the distributee of an eligible rollover distribution from a section 403(b) annuity has a meaningful right to elect a direct rollover, the distributee must be informed of the option. Thus, within a reasonable time period before making an eligible rollover distribution, the payor must provide an explanation to the distributee of his or her right to elect a direct rollover and the income tax withholding consequences of not electing a direct rollover. For purposes of satisfying the reasonable time period, the qualified plan timing rule provided in §1.402(f)-1, Q&A-2 does not apply to section 403(b) annuities. However, a payor of a section 403(b) annuity will be deemed to have provided the explanation within a reasonable time period if the payor complies with the time period in that rule.

Q-4: When do sections 403(b)(8) and (b)(10), as amended by UCA, and this §1.403(b)-2 apply to distributions from section 403(b) annuities?

A-4: (a) *General rule*—(1) *Statutory effective date.* Section 403(b)(8), as amended by UCA, and section 403(b)(10), as amended by UCA, apply to distributions made on or after January 1, 1993. In addition, the underlying section

403(b) annuity document must be amended at the time provided in, and the section 403(b) annuity must operate in accordance with the requirements of §1.401(a)(31)-1, Q&A-19. Section 522 of UCA provides a special effective date for governmental section 403(b) annuities. This special effective date is specified in §1.403(b)-2T (as it appeared in the April 1, 1995 edition of 26 CFR part 1).

(2) *Regulatory effective date.* This section applies to distributions made on or after October 19, 1995. For distributions made on or after January 1, 1993 and before October 19, 1995, §1.403(b)-2T (as it appeared in the April 1, 1995 edition of 26 CFR part 1), applies. However, for distributions made on or after January 1, 1993 but before October 19, 1995, a section 403(b) annuity may satisfy section 403(b)(10) by substituting any or all provisions of this section for the corresponding provisions of §1.403(b)-2T, if any.

[T.D. 8619, 60 FR 49214, Sept. 22, 1995, as amended by T.D. 8880, 65 FR 21315, Apr. 21, 2000]

§ 1.403(c)-1 Taxability of beneficiary under a nonqualified annuity.

(a) *Taxability of vested interest in premiums.* If after August 1, 1969, an employer (whether or not exempt under section 501(a)) pays premiums for an annuity contract for the benefit of an employee, the amount of such premiums shall be included as compensation in the gross income of the employee for the taxable year during which such premiums are paid, but only to the extent that the employee's rights in such premiums are substantially vested (as defined in §1.83-3(b)) at the time such premiums are paid. The preceding sentence shall not apply to contracts referred to in the transitional rule of paragraph (d) (1), (ii), or (iii) of this section, or to premiums subject to §1.403(a)-1(a) or excludable under §1.403(b)-1(b). If any employer has purchased annuity contracts and transferred them to a trust (other than one described in section 401(a)) that is to provide annuity contracts or benefits for his employees, the amounts so paid shall be treated as contributions to a trust described in section 402(b). For the rules relating to the taxation

of the cost of life insurance protection when rights in a life insurance contract are substantially nonvested, see §1.83-1(a)(2).

(b) *Taxability of employee when rights under annuity contract change from non-vested to vested*—(1) *In general.* If, during a taxable year of an employee ending after August 1, 1969, the rights of such employee under an annuity contract purchased for him by an employer (whether or not exempt under section 501(a) or 521(a)) become substantially vested, the value of the annuity contract on the date of such change shall be included in the employee's gross income for such year, to the extent provided in paragraph (b)(2) of this section. The preceding sentence shall not apply, however, to an annuity contract purchased and held as part of a plan which met at the time of such purchase, and continues to meet, the requirements of section 404(a)(2) or an annuity contract referred to in paragraph (d) (ii) or (iii) of this section. For purposes of this section, the value of an annuity contract on the date the employee's rights become substantially vested means the cash surrender value of such contract on such date.

(2) *Extent to which value of annuity contract is includible in employee's gross income.* For purposes of paragraph (b)(1) of this section, the only amount includible in the gross income of the employee is that the portion of the value of the contract on the date of the change that is attributable to premiums which were paid by the employer after August 1, 1969, and which were not excludible from the employer's gross income under §1.403(b)-1(b). However, the includible portion does not include—

(i) The value attributable to a premium paid on the date of such change, and

(ii) The value attributable to premiums described in the transitional rule of paragraph (d)(1) (ii) or (iii) of this section.

See §1.403(b)-1(b)(2) for the treatment of an amount otherwise includible in gross income under section 403(c) as an employer contribution for purposes of the exclusion under section 403(b).

(3) *Partial vesting.* If, during any taxable year of an employee, only part of

his beneficial interest in an annuity contract becomes substantially vested, then only the corresponding part of the value of the annuity contract on the date of such change is includible in the employee's gross income for such taxable year. In such a case, it is first necessary to compute, under the rules in paragraphs (b)(1) and (2) of this section but without regard to any exclusion allowable under §1.403(b)-1(b), the amount which would be includible in the employee's gross income for the taxable year if his entire beneficial interest in the annuity contract had changed to a substantially vested interest during such year. The amount that is includible under this (3) (without regard to the section 403(b) exclusion) is equal to the amount determined under the preceding sentence multiplied by the percent of the employee's beneficial interest which became substantially vested during the taxable year.

(c) *Amounts paid or made available under an annuity contract.* The amounts paid or made available to the employee under an annuity contract subject to this section shall be included in the gross income of the employee for the taxable year in which paid or made available, as provided in section 72 (relating to annuities). Such amounts may be taken into account in computations under sections 1301 through 1305 (relating to income averaging). For rules relating to the treatment of employer contributions as part of the consideration paid by the employee, see section 72(f). See also section 101(b)(2)(D) for rules relating to the treatment of the limited exclusion provided thereunder as part of the consideration paid by the employee.

(d) *Taxability of beneficiary under a nonqualified annuity on or before August 1, 1969.* (1) Except as provided in section 402(d) (relating to taxable years beginning before January 1, 1977), if an employer purchases an annuity contract and if the amounts paid for the contract.

(i) On or before August 1, 1969, or

(ii) After such date, if pursuant to a binding written contract (as defined in §1.83-8(b)(2)) entered into before April 22, 1969, or

(iii) After August 1, 1969, pursuant to a written plan in which the employee participated on April 22, 1969 and under which the obligation of the employer is essentially the same as under a binding written contract, are not subject to paragraph (a) of §1.403(a)-1 or paragraph (a) of §1.403-1, the amount of such contribution shall, to the extent it is not excludible under paragraph (b) of §1.403(b)-1, be included in the income of the employee for the taxable year during which such contribution is made if, at the time the contribution is made, the employee's rights under the annuity contract are nonforfeitable, except for failure to pay future premiums. If the annuity contract was purchased by an employer which is not exempt from tax under section 501(a) or section 521(a), and if the employee's rights under the annuity contract in such a case were forfeitable at the time the employer's contribution was made for the annuity contract, even though they become nonforfeitable later the amount of such contribution is not required to be included in the income of the employee at the time his rights under the contract become nonforfeitable. On the other hand, if the annuity contract is purchased by an employer which is exempt from tax under section 501(a) or section 521(a), all or part of the value of the contract may be includible in the employee's gross income at the time his rights under the contract become nonforfeitable (see section 403(d) prior to the repeal thereof by the Tax Reform Act of 1969 and the regulations thereunder). As to what constitutes nonforfeitable rights of an employee, see §1.402(b)-1(d)(2). The amounts received by or made available to the employee under the annuity contract shall be included in the gross income of the employee for the taxable year in which received or made available, as provided in section 72 (relating to annuities). For taxable years beginning before January 1, 1964, sections 72(e)(3) (relating to the treatment of certain lump sums), as in effect before such date, shall not apply to such amounts. For taxable years beginning after December 31, 1963, such amounts may be taken into account in computations under sections 1301 through 1305 (relating to income aver-

aging). For rules relating to the treatment of employer contributions as part of the consideration paid by the employee, see section 72(f). See also section 101(b)(2)(D) for rules relating to the treatment of the limited exclusion provided thereunder as part of the consideration paid by the employee.

(2) If an employer has purchased annuity contracts and transferred them to a trust, or if an employer has made contributions to a trust for the purpose of providing annuity contracts for his employees as provided in section 402(d) (see paragraph (a) of §1.402(D)-1, the amount so paid or contributed is not required to be included in the income of the employee, but any amount received by or made available to the employee under the annuity contract shall be includible in the gross income of the employee for the taxable year in which received or made available, as provided in section 72 (relating to annuities). For taxable years beginning before January 1, 1964, section 72(e)(3) (relating to the treatment of certain lump sums), as in effect before such date, shall not apply to any amount received by or made available to the employee under the annuity contract. For taxable years beginning after December 31, 1963, amounts received by or made available to the employee under the annuity contract may be taken into account in computations under sections 1301 through 1305 (relating to income averaging). In such case the amount paid or contributed by the employer shall not constitute consideration paid by the employee for such annuity contract in determining the amount of annuity payments required to be included in his gross income under section 72 unless the employee has paid income tax for any taxable year beginning before January 1, 1949, with respect to such payment or contribution by the employer for such year and such tax is not credited or refunded to the employee. In the event such tax has been paid and not credited or refunded the amount paid or contributed by the employer for such year shall constitute consideration paid by the employee for the annuity contract in determining the amount of the annuity required to be included in the income of the employee under section 72.

(3) For taxable years beginning before January 1, 1958, the provisions contained in section 403(c) prior to the amendment made thereto by the Tax Reform Act of 1969 were included in section 403(b) of the Internal Revenue Code of 1954. Therefore, the regulations contained in this paragraph shall, for such taxable years, be considered as the regulations under section 403(b) as in effect for such taxable years. For the rules with respect to contributions paid after August 1, 1969, see paragraphs (a), (b), and (c) of this section.

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

[T.D. 7554, 43 FR 31924, July 24, 1978]

§ 1.403(d)-1 Taxability of employee when rights under contracts purchased by exempt organizations change from forfeitable to nonforfeitable.

(a) *In general.* The provisions of section 403(d), repealed by section 321(b) of the Tax Reform Act of 1969 (83 Stat. 571), applied for taxable years beginning after December 31, 1957, only with respect to amounts paid for an annuity contract—

(1) On or before August 1, 1969, or

(2) After such date, if pursuant to a binding written contract (as defined in § 1.83-8(b)(2)) entered into before April 22, 1969, or

(3) After August 1, 1969, pursuant to a written plan in which the employee participated on April 22, 1969, and under which the obligation of the employer is essentially the same as under a binding written contract.

If, during a taxable year of an employee beginning after December 31, 1957, the rights of such employee under an annuity contract purchased for him by an employer which is exempt from tax under section 501(a) or 521(a) change from forfeitable to nonforfeitable rights, then (except in the case of contracts to which § 1.403(c)-1(b) applies for taxable years ending after August 1, 1969) the value of such annuity contract on the date of such change shall be included in the employee's gross income for such taxable year, to the extent provided in paragraph (b) of this section. However, the preceding sentence does not apply to an annuity

contract purchased and held as part of a plan that at the time of such purchase and at all times thereafter meets the requirements of section 404(a)(2). For purposes of this section, the value of an annuity contract on the date the employee's rights change from forfeitable to nonforfeitable rights means the cash surrender value of such contract on such date. As to what constitutes nonforfeitable rights of an employee, see § 1.402(b)-1(d)(2). For the rules with respect to amounts paid after August 1, 1969, under an annuity contract purchased for an employee by an employer which is exempt from tax under section 501(a) or 521(a), see generally section 403(c) and the regulations thereunder.

(b) *Extent to which value of annuity contract is includible in employee's gross income.* For purposes of paragraph (a) of this section, there shall be included in the gross income of an employee for his taxable year in which his rights under an annuity contract change from forfeitable to nonforfeitable rights only an amount equal to the portion of the value of such contract on the date of such change (1) that is attributable to contributions:

(i) Which were made by the employer while it was exempt from tax under section 501(a) or 521(a);

(ii) Which were made after December 31, 1957; and

(iii) Which were not, at the time they were made, excludable from the employee's gross income under paragraph (a) of § 1.403(b)-1;

and (2) that is not excludable from the employee's gross income under paragraph (b) of § 1.403(b)-1. Thus, although amounts are contributed by an employer after December 31, 1957, toward the purchase for an employee of an annuity contract and, at the time of the contribution, such employer is an organization described in section 501(c)(3) and exempt from tax under section 501(a), the value of such annuity contract attributable to such contributions would not be includible in the employee's gross income for the taxable year in which his rights under the contract change to nonforfeitable rights if such amounts were contributed during a taxable year of the employee beginning before January 1, 1958, and were, therefore, excludable