

June 15, 1963, and the trustee converts the individual insurance contract on F's life to a life annuity which is distributed to him. The life annuity issued on F's life must be non-transferable in order to satisfy the requirements of section 401(g) and this section.

[T.D. 6675, 28 FR 10122, Sept. 17, 1963]

§ 1.401-10 Definitions relating to plans covering self-employed individuals.

(a) *In general.* (1) Certain self-employed individuals may be covered by a qualified pension, annuity, or profit-sharing plan for taxable years beginning after December 31, 1962. This section contains definitions relating to plans covering self-employed individuals. The provisions of §§ 1.401-1 through 1.401-9, relating to requirements which are applicable to all qualified plans, are also generally applicable to any plan covering a self-employed individual. However, in addition to such requirements, any plan covering a self-employed individual is subject to the rules contained in §§ 1.401-11 through 1.401-13. Section 1.401-11 contains general rules which are applicable to any plan covering a self-employed individual who is an employee within the meaning of paragraph (b) of this section. Section 1.401-12 contains special rules which are applicable to plans covering self-employed individuals when one or more of such individuals is an owner-employee within the meaning of paragraph (d) of this section. Section 1.401-13 contains rules relating to excess contributions by, or for, an owner-employee. The provisions of this section and of §§ 1.401-11 through 1.401-13 are applicable to taxable years beginning after December 31, 1962.

(2) A self-employed individual is covered under a qualified plan during the period beginning with the date a contribution is first made by, or for, him under the qualified plan and ending when there are no longer funds under the plan which can be used to provide him or his beneficiaries with benefits.

(b) *Treatment of a self-employed individual as an employee.* (1) For purposes of section 401, a self-employed individual who receives earned income from an employer during a taxable year of such employer beginning after December 31, 1962, shall be considered an employee of such employer for such taxable year. Moreover, such an indi-

vidual will be considered an employee for a taxable year if he would otherwise be treated as an employee but for the fact that the employer did not have net profits for that taxable year. Accordingly, the employer may cover such an individual under a qualified plan during years of the plan beginning with or within a taxable year of the employer beginning after December 31, 1962.

(2) If a self-employed individual is engaged in more than one trade or business, each such trade or business shall be considered a separate employer for purposes of applying the provisions of sections 401 through 404 to such individual. Thus, if a qualified plan is established for one trade or business but not the others, the individual will be considered an employee only if he received earned income with respect to such trade or business and only the amount of such earned income derived from that trade or business shall be taken into account for purposes of the qualified plan.

(3)(i) The term *employee*, for purposes of section 401, does not include a self-employed individual when the term "common-law" employee is used or when the context otherwise requires that the term "employee" does not include a self-employed individual. The term "common-law" employee also includes an individual who is treated as an employee for purposes of section 401 by reason of the provisions of section 7701(a)(20), relating to the treatment of certain full-time life insurance salesmen as employees. Furthermore, an individual who is a common-law employee is not a self-employed individual with respect to income attributable to such employment, even though such income constitutes net earnings from self-employment as defined in section 1402(a). Thus, for example, a minister who is a common-law employee is not a self-employed individual with respect to income attributable to such employment, even though such income constitutes net earnings from self-employment as defined in section 1402(a).

(ii) An individual may be treated as an employee within the meaning of section 401(c)(1) of one employer even

though such individual is also a common-law employee of another employer. For example, an attorney who is a common-law employee of a corporation and who, in the evenings maintains an office in which he practices law as a self-employed individual is an employee within the meaning of section 401(c)(1) with respect to the law practice. This example would not be altered by the fact that the corporation maintained a qualified plan under which the attorney is benefited as a common-law employee.

(4) For the purpose of determining whether an employee within the meaning of section 401(c)(1) satisfies the requirements for eligibility under a qualified plan established by an employer, such an employer may take into account past services rendered by such an employee both as a self-employed individual and as a common-law employee if past services rendered by other employees, including common-law employees, are similarly taken into account. However, an employer cannot take into account only past services rendered by employees within the meaning of section 401(c)(1) if past services rendered to such employer by individuals who are, or were, common-law employees are not taken into account. Past service as described in this subparagraph may be taken into account for the purpose of determining whether an individual who is, or was, an employee within the meaning of section 401(c)(1) satisfies the requirements for eligibility even if such service was rendered prior to January 1, 1963. On the other hand, past service cannot be taken into account for purposes of determining the contributions which may be made on such an individual's behalf under a qualified plan.

(c) *Definition of earned income*—(1) *General rule.* For purposes of section 401 and the regulations thereunder, “earned income” means, in general, net earnings from self-employment (as defined in section 1402(a)) to the extent such net earnings constitute compensation for personal services actually rendered within the meaning of section 911(b).

(2) *Net earnings from self-employment.*

(i) The computation of the net earnings from self-employment shall be made in

accordance with the provisions of section 1402(a) and the regulations thereunder, with the modifications and exceptions described in subdivisions (ii) through (iv) of this subparagraph. Thus, an individual may have net earnings from self-employment, as defined in section 1402(a), even though such individual does not have self-employment income, as defined in section 1402(b), and, therefore, is not subject to the tax on self-employment income imposed by section 1401.

(ii) Items which are not included in gross income for purposes of chapter 1 of the Code and the deductions properly attributable to such items must be excluded from the computation of net earnings from self-employment even though the provisions of section 1402(a) specifically require the inclusion of such items. For example, if an individual is a resident of Puerto Rico, so much of his net earnings from self-employment as are excluded from gross income under section 933 must not be taken into account in computing his net earnings from self-employment which are earned income for purposes of section 401.

(iii) In computing net earnings from self-employment for the purpose of determining earned income, a self-employed individual may disregard only deductions for contributions made on his own behalf under a qualified plan. However, such computation must take into account the deduction allowed by section 404 or 405 for contributions under a qualified plan on behalf of the common-law employees of the trade or business.

(iv) For purposes of determining whether an individual has net earnings from self-employment and, thus, whether he is an employee within the meaning of section 401(c)(1), the exceptions in section 1402(c) (4) and (5) shall not apply. Thus, certain ministers, certain members of religious orders, doctors of medicine, and Christian Science practitioners are treated for purposes of section 401 as being engaged in a trade or business from which net earnings from self-employment are derived. In addition, the exceptions in section 1402(c)(2) shall not apply in the case of any individual who is treated as an employee under section 3121(d)(3) (A), (C),

or (D). Therefore, such individuals are treated, for purposes of section 401, as being engaged in a trade or business from which net earnings from self-employment may be derived.

(3) *Compensation for personal services actually rendered.* (i) For purposes of section 401, the term “earned income” includes only that portion of an individual’s net earnings from self-employment which constitutes earned income as defined in section 911(b) and the regulations thereunder. Thus, such term includes only professional fees and other amounts received as compensation for personal services actually rendered by the individual. There is excluded from “earned income” the amount of any item of income, and any deduction properly attributable to such item, if such amount is not received as compensation for personal services actually rendered. Therefore, an individual who renders no personal services has no “earned income” even though such an individual may have net earnings from self-employment from a trade or business.

(ii) If a self-employed individual is engaged in a trade or business in which capital is a material income-producing factor, then, under section 911(b), his earned income is only that portion of the net profits from the trade or business which constitutes a reasonable allowance as compensation for personal services actually rendered. However, such individual’s earned income cannot exceed 30 percent of the net profits of such trade or business. The net profits of the trade or business is not necessarily the same as the net earnings from self-employment derived from such trade or business.

(4) *Minimum earned income when both personal services and capital are material income-producing factors.* (i) If a self-employed individual renders personal services on a full-time, or substantially full-time, basis to only one trade or business, and if with respect to such trade or business capital is a material income-producing factor, then the amount of such individual’s earned income from the trade or business is considered to be not less than so much of his share in the net profits of such trade or business as does not exceed \$2,500.

(ii) If a self-employed individual renders substantial personal services to more than one trade or business, and if with respect to all such trades or businesses such self-employed individual actually renders personal services on a full-time, or substantially full-time, basis, then the earned income of the self-employed individual from trades or businesses for which he renders substantial personal services and in which both personal services and capital are material income-producing factors is considered to be not less than—

(A) So much of such individual’s share of the net profits from all trades or businesses in which he renders substantial personal services as does not exceed \$2,500, reduced by.

(B) Such individual’s share of the net profits of any trade or business in which only personal services is a material income-producing factor.

However, in no event shall the share of the net profits of any trade or business in which capital is a material income-producing factor be reduced below the amount which would, without regard to the provisions of this subdivision, be treated as the earned income derived from such trade or business under section 911(b). In making the computation required by this subdivision, any trade or business with respect to which the individual renders substantial personal services shall be taken into account irrespective of whether a qualified plan has been established by such trade or business.

(iii) If the provisions of subdivision (ii) of this subparagraph apply in determining the earned income of a self-employed individual, and such individual is engaged in two or more trades or businesses in which capital and personal services are material income-producing factors, then the total amount treated as the earned income shall be allocated to each such trade or business for which he performs substantial personal services in the same proportion as his share of net profits from each such trade or business bears to his share of the total net profits from all such trades or businesses. Thus, in such case, the amount of earned income attributable to any such trade or business is computed by multiplying the total earned income as determined

under subdivision (ii) of this subparagraph by the individual's net profits from such trade or business and dividing that product by the individual's total net profits from all such trades or businesses.

(iv) For purposes of this subparagraph, the determination of whether an individual renders personal services on a full-time, or substantially full-time, basis is to be made with regard to the aggregate of the trades and businesses with respect to which the employee renders substantial personal services as a common-law employee or as a self-employed individual. However, for all other purposes in applying the rules of this subparagraph, a trade or business with respect to which an individual is a common-law employee shall be disregarded.

(d) *Definition of owner-employee.* For purposes of section 401 and the regulations thereunder, the term "owner-employee" means a proprietor of a proprietorship, or, in the case of a partnership, a partner who owns either more than 10 percent of the capital interest, or more than 10 percent of the profits interest, of the partnership. Thus, an individual who owns only 2 percent of the profits interest but 11 percent of the capital interest of a partnership is an owner-employee. A partner's interest in the profits and the capital of the partnership shall be determined by the partnership agreement. In the absence of any provision regarding the sharing of profits, the interest in profits of the partners will be determined in the same manner as their distributive shares of partnership taxable income. However, a guaranteed payment (as described in section 707(c)) is not considered a distributive share of partnership income for such purpose. See section 704(b), relating to the determination of the distributive share by the income or loss ratio, and the regulations thereunder. In the absence of a provision in the partnership agreement, a partner's capital interest in a partnership shall be determined on the basis of his interest in the assets of the partnership which would be distributable to such partner upon his withdrawal from the partnership, or upon liquidation of the partnership, whichever is the greater.

(e) *Definition of employer.* (1) For purposes of section 401, a sole proprietor is considered to be his own employer, and the partnership is considered to be the employer of each of the partners. Thus, an individual partner is not an employer who may establish a qualified plan with respect to his services to the partnership.

(2) Regardless of the provision of local law, a partnership is deemed, for purposes of section 401, to be continuing until such time as it is terminated within the meaning of section 708, relating to the continuation of a partnership.

[T.D. 6675, 28 FR 10123, Sept. 17, 1963]

§ 1.401-11 General rules relating to plans covering self-employed individuals.

(a) *Introduction.* This section provides certain rules which supplement, and modify, the rules of §§ 1.401-1 through 1.401-9 in the case of a qualified pension, annuity, or profit-sharing plan which covers a self-employed individual who is an employee within the meaning of section 401(c)(1). The provisions of this section apply to taxable years beginning after December 31, 1962. Except as otherwise provided, paragraphs (b) through (m) of this section apply to taxable years beginning after December 31, 1962. Paragraph (n) of this section applies to plan years determined in accordance with paragraph (n)(1) of this section.

(b) *General rules.* (1) If the amount of employer contributions for common-law employees covered under a qualified plan is related to the earned income (as defined in section 401(c)(2)) of a self-employed individual, or group of self-employed individuals, such a plan is a profit-sharing plan (as described in paragraph (b)(1)(ii) of § 1.401-1) since earned income is dependent upon the profits of the trade or business with respect to which the plan is established. Thus, for example, a plan, which provides that the employer will contribute 10 percent of the earned income of a self-employed individual but no more than \$2,500, and that the employer contribution on behalf of common-law employees shall be the same percentage of their salaries as the contribution on behalf of the self-employed individual