

(b) *Examples.* The rules of paragraph (a) of this section may be illustrated by the following examples:

Example (1). The B Company Pension Trust forms a part of a pension plan which is funded by individual level annual premium annuity contracts. The plan requires ten years of service prior to obtaining a vested right to benefits under the plan. One of the company's employees resigns his position after two years of service. The insurance company paid to the trustee the cash surrender value of the contract—\$750. The B Company must reduce its next contribution to the pension trust by this amount.

Example (2). The C Corporation's trustee pension plan has been in existence for 20 years. It is funded by individual contracts issued by an insurance company, and the premiums thereunder are paid annually. Under such plan, the annual premium accrued for the year 1966 is due and is paid on January 2, 1966, and on July 1 of the same year the plan is terminated due to the liquidation of the employer. Some forfeitures were incurred and collected by the trustee with respect to those participants whose employment terminated between January 2 and July 1. The plan provides that the amount of such forfeitures is to be applied to provide additional annuity benefits for the remaining employees covered by the plan. The pension plan of the C Corporation satisfies the provisions of section 401(a)(8). Although forfeitures are used to increase benefits in this case, this use of forfeitures is permissible since no further contributions will be made under the plan.

(c) *Effective date.* This section applies to taxable years of a qualified plan commencing after September 30, 1963. However, a plan which is qualified on September 30, 1963, will not be disqualified merely because it does not expressly include the provisions prescribed by this section.

[T.D. 6675, 28 FR 10121, Sept. 17, 1963]

§ 1.401-8 Custodial accounts prior to January 1, 1974.

(a) *Treatment of a custodial account as a qualified trust.* For taxable years of a plan beginning after December 31, 1962, a custodial account may be used, in lieu of a trust, under any pension, profit-sharing, or stock bonus plan, described in section 401 if the requirements of paragraph (b) of this section are met. A custodial account may be used under such a plan, whether the plan covers common-law employees, self-employed individuals who are

treated as employees by reason of section 401(c), or both. The use of a custodial account as part of a plan does not preclude the use of a trust or another custodial account as part of the same plan. A plan under which a custodial account is used may be considered in connection with other plans of the employer in determining whether the requirements of section 401 are satisfied. For regulations relating to the period after December 31, 1973, see § 1.401(f)-11.

(b) *Rules applicable to custodial accounts.* (1) A custodial account shall be treated for taxable years beginning after December 31, 1962, as a qualified trust under section 401 if such account meets the following requirements described in subdivisions (i) through (iii) of this subparagraph:

(i) The custodial account must satisfy all the requirements of section 401 that are applicable to qualified trusts. See subparagraph (2) of this paragraph.

(ii) The custodian of the custodial account must be a bank.

(iii) The custodial agreement provides that the investment of the funds in the account is to be made—

(A) Solely in stock of one or more regulated investment companies which is registered in the name of the custodian or its nominee and with respect to which an employee who is covered by the plan is the beneficial owner, or

(B) Solely in annuity, endowment, or life insurance contracts, issued by an insurance company and held by the custodian until distributed pursuant to the terms of the plan. For purposes of the preceding sentence, a face-amount certificate described in section 401(g) and § 1.401-9 is treated as an annuity issued by an insurance company.

See subparagraphs (3) and (4) of this paragraph.

(2) As a result of the requirement described in subparagraph (1)(i) of this paragraph (relating to the requirements applicable to qualified trusts), the custodial account must, for example, be created pursuant to a written agreement which constitutes a valid contract under local law. In addition, the terms of the contract must make it impossible, prior to the satisfaction of all liabilities with respect to the employees and their beneficiaries covered by the plan, for any part of the funds of

the custodial account to be used for, or diverted to, purposes other than for the exclusive benefit of the employees or their beneficiaries as provided for in the plan (see paragraph (a) of § 1.401-2).

(3) The requirement described in subparagraph (1)(iii) of this paragraph, relating to the investment of the funds of the plan, applies, for example, to the employer contributions under the plan, any employee contributions under the plan, and any earnings on such contributions. Such requirement also applies to capital gains realized upon the sale of stock described in (A) of such subdivision, to any capital gain dividends received in connection with such stock, and to any refunds described in section 852(b)(3)(D)(ii) (relating to undistributed capital gains of a regulated investment company) which is received in connection with such stock. However, since such requirement relates only to the investment of the funds of the plan, the custodian may deposit funds with a bank, in either a checking or savings account, while accumulating sufficient funds to make additional investments or while awaiting an appropriate time to make additional investments.

(4) The requirement in subparagraph (1)(iii)(A) of this paragraph that an employee covered by the plan be the beneficial owner of the stock does not mean that the employee who is the beneficial owner must have a nonforfeitable interest in the stock. Thus, a plan may provide for forfeitures of an employee's interest in such stock in the same manner as plans which use a trust. In the event of a forfeiture of an employee's beneficial ownership in the stock of a regulated investment company, the beneficial ownership of such stock must pass to another employee covered by the plan.

(c) *Effects of qualification.* (1) Any custodial account which satisfies the requirements of section 401(f) shall be treated as a qualified trust for all purposes of the Internal Revenue Code of 1954. Accordingly, such a custodial account shall be treated as a separate legal person which is exempt from the income tax by section 501(a). On the other hand, such a custodial account is required to file the returns described in sections 6033 and 6047 and to supply any

other information which a qualified trust is required to furnish.

(2) In determining whether the funds of a custodial account are distributed or made available to an employee or his beneficiary, the rules which under section 402(a) are applicable to trusts will also apply to the custodial account as though it were a separate legal person and not an agent of the employee.

(d) *Effect of loss of qualification.* If a custodial account which has qualified under section 401 fails to qualify under such section for any taxable year, such custodial account will not thereafter be treated as a separate legal person, and the funds in such account shall be treated as made available within the meaning of section 402(a)(1) to the employees for whom they are held.

(e) *Definitions.* For purposes of this section—

(1) The term *bank* means a bank as defined in section 401(d)(1).

(2) The term *regulated investment company* means any domestic corporation which issues only redeemable stock and is a regulated investment company within the meaning of section 851(a) (but without regard to whether such corporation meets the limitations of section 851(b)).

(Secs. 401(f)(2), 7805, Internal Revenue Code of 1954 (88 Stat. 939 and 68A Stat. 917; 26 U.S.C. 401(f)(2), 7805))

[T.D. 6675, 28 FR 10121, Sept. 17, 1963, as amended by T.D. 7565, 43 FR 41204, Sept. 15, 1978. Redesignated and amended by T.D. 7748, 46 FR 1695, Jan. 7, 1981]

§ 1.401-9 Face-amount certificates—nontransferable annuity contracts.

(a) *Face-amount certificates treated as annuity contracts.* Section 401(g) provides that a face-amount certificate (as defined in section 2(a)(15) of the Investment Company Act of 1940 (15 U.S.C. sec. 80a-2)) which is not transferable within the meaning of paragraph (b)(3) of this section shall be treated as an annuity contract for purposes of sections 401 through 404 for any taxable year of a plan subject to such sections beginning after December 31, 1962. Accordingly, there may be established for any such taxable year a qualified plan under which such face-amount certificates are purchased for the participating employees without the creation