

ERISA. To the extent that an amendment providing for a significant reduction in the rate of future benefit accrual or a significant reduction in an early retirement benefit or retirement-type subsidy has an effective date that is earlier than the termination date (or date of termination, as applicable) established under section 4048 of *ERISA*, that amendment is subject to section 4980F and section 204(h). Accordingly, the plan administrator must provide section 204(h) notice (either separately, with, or as part of the notice of intent to terminate) with respect to such an amendment.

Q-18. What are the effective dates of section 4980F, section 204(h), as amended by EGTRRA, and these regulations?

A-18. (a) *Statutory effective date*—(1) *General rule*. Section 4980F and section 204(h), as amended by EGTRRA, apply to plan amendments taking effect on or after June 7, 2001 (statutory effective date), which is the date of enactment of EGTRRA.

(2) *Transition rule*. For amendments applying after the statutory effective date in paragraph (a)(1) of this Q&A-18 and prior to the regulatory effective date in paragraph (c) of this Q&A-18, the requirements of section 4980F(e)(2) and (3) of the Internal Revenue Code and section 204(h), as amended by EGTRRA, are treated as satisfied if the plan administrator makes a reasonable, good faith effort to comply with those requirements.

(3) *Special notice rule*—(i) *In general*. Notwithstanding Q&A-9 of this section, section 204(h) notice is not required by section 4980F(e) of the Internal Revenue Code or section 204(h), as amended by EGTRRA, to be provided prior to September 7, 2001 (the date that is three months after the date of enactment of EGTRRA).

(ii) *Reasonable notice*. The requirements of section 4980F and section 204(h), as amended by EGTRRA, do not apply to any plan amendment that takes effect on or after June 7, 2001 if, before April 25, 2001, notice was provided to participants and beneficiaries adversely affected by the plan amendment (and their representatives) which was reasonably expected to notify them of the nature and effective date of the plan amendment. For purposes

of this paragraph (a)(3)(ii), notice that complies with § 1.411(d)-6 of this chapter, as it appeared in the April 1, 2001 edition of 26 CFR part 1, is deemed to be notice which was reasonably expected to notify participants and beneficiaries adversely affected by the plan amendment (and their representatives) of the nature and effective date of the plan amendment.

(b) *Regulatory effective date*—(1) *General effective date*. Except for Q&A-7(a)(2), Q&A-1 through Q&A-18 of this section apply to amendments with an effective date that is on or after September 2, 2003.

(2) *Effective date for Q&A-7(a)(2)*. Q&A-7(a)(2) of this section applies to amendments with an effective date that is on or after January 1, 2004.

(c) *Amendments taking effect prior to June 7, 2001*. For rules applicable to amendments taking effect prior to June 7, 2001, see § 1.411(d)-6 of this chapter, as it appeared in the April 1, 2001 edition of 26 CFR part 1.

[T.D. 9052, 68 FR 17281, Apr. 9, 2003]

§ 54.4981A-1T Tax on excess distributions and excess accumulations (temporary).

The following questions and answers relate to the tax on excess distributions and excess accumulations under section 4981A of the Internal Revenue Code of 1986, as added by section 1133 of the Tax Reform Act of 1986 (Pub. L. 99-514) (TRA '86).

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a. General Provisions and Excess Distributions

a-1: Q. What changes were made by section 1133 of TRA '86 regarding excise taxes applicable to distributions from qualified employer plans and individual retirement plans?

A. Section 1133 of TRA '86 added section 4981A to the Code. Section 4981A imposes an excise tax of 15 percent on (a) excess distributions, as defined in section 4981A(c)(1) and Q&A a-2 of this section, and (b) excess accumulations,

as defined in section 4981A(d)(3) and Q&A d-2 of this section. The excise tax on excess distributions generally applies to excess distributions made after December 31, 1986 (see Q&A c-6 of this section). The excise tax on excess accumulations applies to estates of decedents dying after December 31, 1986 (see Q&A d-11 of this section). Excess distributions are certain distributions from qualified employer plans and individual retirement plans. Excess accumulations are certain amounts held on the date of death of an employee or individual by qualified plans and individual retirement plans.

a-2: Q. How are excess distributions defined?

A. Excess distributions are generally defined as the excess of the aggregate amount of distributions received by or with respect to an individual during a calendar year over the greater of (a) \$150,000 (unindexed) or (b) \$112,500 (indexed as provided in Q&A a-9 of this section beginning in 1988 for cost-of-living increases). Certain individuals may elect to have the portion of their excess distributions that is subject to tax determined under a "special grandfather" rule that is described below (see Q&A b-1 through b-14 of this section).

a-3: Q. Distributions from what plans and arrangements are taken into account in applying section 4981A?

A. (a) *General rule.* Section 4981A applies to distributions under any qualified employer plan or individual retirement plan described in section 4981A(e). For this purpose, a qualified employer plan means any—

(1) Qualified pension, profit-sharing or stock bonus plan described in section 401(a) that includes a trust exempt from tax under section 501(a);

(2) Annuity plan described in section 403(a);

(3) Annuity contract, custodial account, or retirement income account described in section 403(b)(1), 403(b)(7) or 403(b)(9); and

(4) Qualified bond purchase plan described in section 405(a) prior to that section's repeal by section 491(a) of the Tax Reform Act of 1984 (TRA '84).

(b) *Individual retirement plan.* An individual retirement plan is defined in section 7701(a)(37) and means any indi-

vidual retirement account described in section 408(a) or individual retirement annuity described in section 408(b). Also, an individual retirement plan includes a retirement bond described in section 409(a) prior to that section's repeal by section 491(b) of the Tax Reform Act of 1984 (TRA '84).

(c) *Other distributions.* (1) Distributions under any plan, contract or account that has at any time been treated as a qualified employer plan or individual retirement plan described in paragraph (a) or (b) of this Q&A a-3 will be treated for purposes of section 4981A as distributions from a qualified employer plan or individual retirement plan whether or not such plan, contract, or account satisfies the applicable qualification requirements at the time of the distribution.

(2)(i) For purposes of this paragraph (c), an employer plan will be considered to have been treated as a qualified employer plan if any employer maintaining the plan has at any time filed an income tax return and claimed deductions that would be allowable under section 404 (and that were not disallowed) only if the plan was a qualified employer plan under section 401(a) or 403(a). Similarly, if an income tax return has been filed at any time with respect to the trust (or plan or insurance company), and the income of the trust (insurance company, etc.) is reported (and is not disallowed) based on the trust (or plan) being treated as a qualified employer plan described in section 401(a), or 403 (a) or (b), then the employer plan is considered to have been treated as a qualified employer plan.

(ii) For purposes of this paragraph (c), an individual retirement plan (IRA) will be considered to have been treated as a qualified IRA if any contributions to the IRA were either deducted (or designated as a nondeductible contribution described in section 408(o)) on a filed individual income tax return or excluded from an individual's gross income on a filed income tax return because such contributions were reported as regular contributions or rollover contributions (such as those described in section 402(a)(5), 403(a)(4), 403(b)(8) or 408(d)(3)) to an IRA described in section 408 (a) or (b) (or section 409 of pre-1984

law). Similar treatment applies to an employer contribution to a simplified employee pension described in section 408(k), if such contribution is deducted on an employer's filed income tax return, including a self-employed individual's return.

a-4: Q. Which distributions with respect to an individual under a qualified employer plan or an individual retirement plan are excluded from consideration for purposes of determining an individual's excess distributions?

A. (a) *Exclusions.* In determining the extent to which an individual has excess distributions for a calendar year, the following distributions are disregarded—

(1) Any distribution received by any person with respect to an individual as a result of the death of that individual.

(2) Any distribution with respect to an individual that is received by an alternate payee under a qualified domestic relations order within the meaning of section 414(p) that is includible in the income of the alternate payee.

(3) Any distribution with respect to an individual that is attributable to the individual's investment in the contract as determined under the rules of section 72(f). This would include, for example, distributions that are excluded from gross income under section 72 because they are treated as a recovery of after-tax employee contributions from a qualified employer plan or nondeductible contributions from an individual retirement plan.

(4) Any portion of a distribution to the extent that it is not included in gross income by reason of a rollover contribution described in section 402(a)(5), 403(a)(4), 403(b)(8), or 408(d)(3).

(5) Any health coverage or any distribution of medical benefits provided under an arrangement described in section 401(h) to the extent that the coverage or distribution is excludible under section 104, 105, or 106.

(b) *Alternate payee.* Any distributions to an alternate payee described in paragraph (a)(2) of this Q&A a-4 must be taken into account by such alternate payee for purposes of calculating the excess distributions received by (or excess accumulations held by) the alternate payee.

a-5: Q. If an annuity contract that represents an irrevocable commitment to provide an employee's benefits under the plan is distributed to an individual, how are the distribution of such annuity contract and distributions of amounts under such a contract taken into account for purposes of calculating excess distributions?

A. Except to the extent that the value of an annuity contract is includible in income in the year the contract is distributed or any subsequent year, the distribution of an annuity contract (including a group annuity contract) in satisfaction of plan liabilities is disregarded for purposes of calculating excess distributions. Any amounts that are actually distributed under the contract to the individual (to the extent not excluded under Q&A a-4 of this section) or are otherwise includible in income with respect to the contract (e.g., by reason of the inclusion in income of the value of the annuity contract in the year of the contract's distribution or any subsequent year) are taken into account for purposes of calculating excess distributions for the calendar year during which such amounts are received or otherwise includible in income. For purposes of this Q&A a-5, the term *plan* means any qualified employer plan or individual retirement plan specified in section 4981A(e) and Q&A a-3 of this section.

a-6: Q. Are minimum distributions required under section 401(a)(9), 408(a)(6), 408(b)(3) or 403(b)(10) taken into account to determine excess distributions?

A. Yes. Distributions received during a calendar year are taken into account in determining an individual's excess distributions for such calendar year even though such distributions are required under section 401(a)(9), 408(a)(6), 408(b)(3) or 403(b)(10). For example, minimum distributions under section 401(a)(9) received during the 1987 calendar year for calendar years 1985 and 1986 will be subject to section 4981A as distributions for 1987.

a-7: Q. Are distributions of excess deferrals permitted under section 402(g)(2), or distributions of excess contributions or excess aggregate contributions permitted under section 401(k) or (m), or distributions of IRA

contributions permitted under section 408(d) (4) or (5) taken into account for purposes of calculating excess distributions?

A. No. Distributions of excess deferrals, excess contributions, excess aggregate contributions, distributions of IRA contributions, and income allocable to such contributions or deferrals, that are made in accordance with the provisions of sections 402(g)(2), 401(k)(8), 401(m)(6), or 408(d) (4) or (5) are not taken into account for purposes of calculating excess distributions.

a-8: Q. What distributions from qualified employer plans or individual retirement plans are taken into account in determining an individual's excess distributions?

A. With the exception of distributions noted above in Q&As a-4, a-5, and a-7 of this section, all distributions from qualified employer plans or individual retirement plans must be taken into account in determining an individual's excess distributions for the calendar year in which such distributions are received. In general, all such distributions are taken into account whether or not they are currently includible in income. Thus, for example, net unrealized appreciation in employer securities described in section 402(a) is taken into account in the year distributed. However, health coverage or distributions of medical benefits provided under an arrangement described in section 401(h) that are excludible from income under section 104, 105, or 106 are not subject to section 4981A. In addition, distributions that are excludible from income because they are rolled over to a plan or an individual retirement account are not taken into account. (See Q&A a-4(a) (4) and (5) of this section). Amounts that are includible in income for a calendar year are treated as distributions and, thus, are taken into account even if the amounts are not actually distributed during such year. Thus, deemed distributions to provide insurance coverage includible in income under section 72 (PS-58 amounts), loan amounts treated as deemed distributions under section 72(p), and amounts includible under section 402(b) or section 403(c) by reason of the employer plan or individual retirement plan not being quali-

fied during the year are taken into account.

a-9: Q. Will the dollar threshold amount used to determine an individual's excess distributions be adjusted for inflation in calendar years after 1987?

A. Beginning in 1988, the \$112,500 threshold amount is adjusted to reflect post-1986 cost-of-living increases (COLAs) at the same time and in the same manner as the adjustment described in section 415(d). The threshold amount is adjusted even though the distribution is from a defined contribution plan that is subject to a freeze on COLAs because the defined benefit plan limit is below \$120,000 (see section 415(c)(1)(A)). However, the \$150,000 threshold amount is not adjusted to reflect such increases.

b. Special Grandfather Rule

b-1: Q. How are benefits accrued before TRA '86 treated under the excise tax provisions described in section 4981A?

A. (a) *Grandfather amount.* Certain eligible individuals may elect to use a special grandfather rule that exempts from the excise tax the portion of distributions treated as a recovery of such individual's total benefits accrued on or before August 1, 1986 (grandfather amount). However, distributions that are treated as a recovery of the grandfather amount are taken into account in determining the extent to which other distributions are excess distributions (see Q&A b-4 of this section). Under this special grandfather rule, the grandfather amount equals the value of an individual's total benefits (as described in Q&As b-8 and b-9 of this section) in all qualified employer plans and individual retirement plans on August 1, 1986. An individual's benefits in such plans include amounts determinable on August 1, 1986, that are payable to the individual under a qualified domestic relations order within the meaning of section 414(p) (QDRO). However, QDRO benefits that, when distributed, are includible in the income of the alternate payee are not included in the employee's grandfathered amount. Further, plan benefits that

are attributable to a deceased individual and that are payable to an eligible individual as a beneficiary are generally not included in determining the eligible individual's grandfather amount. Procedures for determining the grandfather amount are described in Q&As b-11 through b-14 of this section.

(b) *Recovery of grandfather amount.* The portion of any distribution made after August 1, 1986, that is treated as a recovery of a grandfather amount depends on which of two grandfather recovery methods the individual elects. The two alternative methods are described in the Q&As b-11 through b-14 of this section. The amount of the distribution for a year that is treated as a recovery of a grandfather amount in a year is applied to reduce the individual's unrecovered grandfather amount for future years (*i.e.*, the individual's accrued benefits as described in Q&As b-8 and b-9 on August 1, 1986, reduced by previous distributions treated as a recovery of a grandfather amount) on a dollar for dollar basis until the individual's unrecovered grandfather amount has been reduced to zero. When the individual's grandfather amount has been reduced to zero, the special grandfather rule ceases to apply and the entire amount of any subsequent excess distributions received is subject to the 15 percent excise tax.

b-2: Q. Who may elect to use the special grandfather rules?

A. Any individual whose accrued benefits as described in Q&As b-8 and b-9 of this section in all qualified plans and individual retirement plans on August 1, 1986 (initial grandfather amount) have a value of at least \$562,500 may elect to use the special grandfather rule.

b-3: Q. How does an eligible individual make a valid election to use the special grandfather rule?

A. (a) *Form of election.* An individual who is eligible to use the special grandfather rule must affirmatively elect to use that rule. The election is made on a Form 5329 filed with the individual's income tax return (Form 1040, etc.) for a taxable year beginning after December 31, 1986, and before January 1, 1989 (*i.e.*, the 1987 or 1988 taxable year).

(b) *Information required.* The individual must report the following information on the Form 5329:

(1) The individual's initial grandfather amount.

(2) The grandfather recovery method to be used.

(3) Such other information as is required by the Form 5329.

(c) *Deadline for election.* The deadline for filing such election is the due date, calculated with extensions, for filing the individual's 1988 income tax return. If an individual dies before the expiration of such deadline, an election, or the revocation of a prior election, may be made as part of the final income tax return filed on behalf of such deceased individual by the deceased individual's personal representative. An election or revocation of a prior election may also be filed before the expiration of such deadline with Schedule S (Form 706). See Q&A c-7 of this section.

(d) *Revocation of election.* Elections filed before the deadline may be revoked by filing an amended income tax return for any applicable year. A change in the grandfather recovery method is considered a revocation of a prior election and an amended Form 5329 must be filed for any prior year in which a different grandfather recovery method was used. Thus, a change in the election may require a change in the 1987 tax return. An individual must refile for 1987 based on the new election if additional tax is owed. However, an election (or nonelection) is irrevocable after the filing deadline for the taxable year beginning in 1988 has passed. Thus, an individual who has not made an election by the last day plus extensions for filing the 1988 return may not do so through an amended return.

(e) *Subsequent years.* (1) Any eligible individual who has elected the special grandfather rule must attach to the individual's income tax return for all subsequent taxable years in which the individual receives excess distributions (determined without regard to the grandfather rule) a copy of the Form 5329 on which the individual elected the grandfather rule. A copy of the Form 5329 on which the individual (or the individual's personal representative) elected the grandfather rule must also

be filed with Schedule S (Form 706) unless the initial election is filed with such schedule.

(2) The individual must also make such other reports in the form and at the time as the Commissioner may prescribe. See Q&A c-7 of this section for the applicable reporting requirements if the individual or the individual's estate is liable for any tax on excess distributions or on an excess accumulation under section 4981A (a) or (d).

b-4: Q. How individuals who have elected to use the special grandfather rule determine the extent to which their distributions for any calendar year are excess distributions?

A. (a) Excess distributions under grandfather rule, threshold amount. Individuals who elect to use the special grandfather rule are not eligible to use the \$150,000 threshold amount in computing their excess distributions for any calendar year. Instead, such electing individuals must compute their excess distributions for a calendar year using a \$112,500 (indexed for cost-of-living increases) threshold amount. The rule of this paragraph (a) applies for all calendar years, including the calendar year in which an individual's unrecovered grandfather amount has been reduced to zero and all subsequent calendar years. Once the indexed amount has increased to \$150,000 or more, the threshold amount will be the same for all individuals.

(b) Base for excise tax under grandfather rule. Although the portion of any distribution that is treated as a recovery of an individual's grandfather amount is not subject to the excise tax, such portion must be taken into account in determining the extent to which the individual has excess distributions for a calendar year. The effect of this rule is that the amount against which the 15 percent excise tax is applied for any calendar year during which a grandfather amount is recovered equals the individual's distributions for such year reduced by the greater of (1) the applicable threshold amount for such year or (2) the grandfather amount recovered for such year. (See the examples in Q&A b-14 of this section.)

b-5: Q. How is the value of an individual's total accrued benefits on August

1, 1986, calculated for purposes of determining (a) whether an individual is eligible to elect the special grandfather rule and (b) the amount of any electing individual's initial grandfather amount under such rule?

A. (a) Introduction. The value of an individual's total accrued benefits on August 1, 1986, is the sum of the values of the individual's accrued benefits on such date under all qualified employer plans or individual retirement plans, as determined under the Q&A b-5. If such value exceeds \$562,500, the individual may elect the special grandfather rule. In such case, the value so determined may be applied against distributions as determined under this section, whether or not such distributions are from the same plan or IRA for which such grandfather amount is determined. For purposes of determining the value of accrued benefits on August 1, 1986, an annuity contract or an individual's interest in a group annuity contract described in Q&A a-5 of this section is treated as an accrued benefit under the qualified retirement plan or IRA from which it was distributed and an IRA is treated as a defined contribution plan.

(b) Defined benefit plan—(1) General rule. The amount of an individual's accrued benefit on August 1, 1986, under a defined benefit plan is determined as of that date under the provisions of the plan based on the individual's service and compensation on that date. The present value of such benefit is determined by an actuarial valuation of such accrued benefit performed as of August 1, 1986. Alternatively, accrued benefits may be determined as of July 31, 1986. In such case, the applicable rules are applied by substituting the July 31 date for the August 1 date in the applicable provisions. (See Q&A b-9 of this section for rules for determining the amount of benefits and values and the actuarial assumptions to be used in such determination.)

(2) Alternative method. Alternatively, the present value of an individual's accrued benefit on August 1, 1986, may be determined using the following method:

(i) Determine the amount of the individual's actual accrued benefit (prior benefit) on the valuation date that immediately precedes August 1, 1986

(prior date). The valuation date for purposes of using this alternative method is the valuation date used for purposes of section 412. In making this determination, plan amendments that are adopted after that prior date are disregarded.

(ii) Determine the amount of the individual's adjusted accrued benefit (adjusted prior benefit) on the prior date by reducing the prior benefit in paragraph (b)(2)(i) of this Q&A b-5 by the amount of distributions that reduce the accrued benefit or transfers from the plan and by increasing the prior benefit in paragraph (b)(2)(i) of this Q&A b-5 by any increase in benefit resulting from either transfers to the plan or plan amendments that were made (or, in the case of a plan amendment, both adopted and effective) after the prior valuation date, but on or before August 1, 1986.

(iii) Determine the amount of the individual's actual accrued benefit (future benefit) on the valuation date immediately following August 1, 1986 (next date). In making this determination, plan amendments, etc. that are either adopted or effective after August 1 are disregarded.

(iv) Determine the amount of the individual's adjusted accrued benefit (adjusted future benefit) on the next date by increasing the future benefit in paragraph (b)(2)(iii) of this Q&A b-5 by the amount of any distributions that reduce the accrued benefit or transfers from the plan and by reducing the future benefit in paragraph (b)(2)(iii) of this Q&A b-5 by the amount of any transfer to the plan that was made after August 1, 1986, but on or before the next valuation date to the amount in paragraph (b)(2)(iii) of this Q&A b-5.

(v) Calculate the weighted average of paragraphs (b)(2)(ii) and (b)(2)(iv) of this Q&A b-5, where the weights applied are the number of complete calendar months separating the applicable prior date and the applicable next date, respectively, and August 1, 1986.

(vi) Determine the actuarial present value of the benefit in paragraph (b)(2)(v) of this Q&A b-5 as of August 1, 1986, using the methods and assumptions described in Q&A b-9 of this section.

The grandfather amount on August 1, 1986, attributable to the accrued benefits under the defined benefit plan is equal to the amount determined in paragraph (b)(2)(vi) of this Q&A b-5.

(3) *Certain insurance plans treated as defined contribution plans.* (i) Accrued benefits not in pay status under a plan satisfying the requirements of section 411(b)(1)(F) are determined under the rules in paragraph (c) of this Q&A b-5 for defined contribution plans. For purposes of applying paragraph (c) of this Q&A b-5 to such benefits, the cash surrender value of the contract is substituted for the account balance. If accrued benefits are in pay status under such a plan, the rules of this paragraph (b) apply to such benefits.

(ii) Accrued benefits not in pay status that are attributable to voluntary employee contributions (including rollover amounts) to a defined benefit plan are determined under the rules in paragraph (c) of this Q&A b-5 as if the account balance attributable thereto is under a defined contribution plan. If such benefits are in pay status and are used to fund the benefit under the defined plan, the rules of this paragraph (b) apply to such benefits.

(c) *Defined contribution plan—(1) General rule.* The value of an individual's accrued benefit on August 1, 1986, under a defined contribution plan (including IRAs) is the value of the individual's account balance on such date (or on the immediately preceding day). Paragraph (b)(3) of this Q&A b-5 requires that benefits derived from certain insured plans and from voluntary contributions to a defined benefit plan be determined under the rules of this paragraph (c).

(2) *Alternative method.* Alternatively, if a valuation was not performed as of August 1, 1986 (or as of the immediately preceding day), the value of an individual's accrued benefit may be determined as follows:

(i) Determine the value of the individual's account balance on the valuation date immediately preceding August 1, 1986 (prior valuation date).

(ii) Determine the value of the individual's adjusted account balance on the prior valuation date by subtracting (or adding, respectively) the amount of any distribution, including a transfer

to another plan or a forfeiture from the account balance (or the amount of any allocation to the account balance, including a transfer from another plan, rollover received or forfeiture from another account) that was made after the prior valuation date but on or before August 1, 1986, from (or to) the amount in paragraph (c)(2)(i) of this Q&A b-5.

(iii) Determine the value of the individual's account balance on the valuation date immediately following August 1, 1986 (next valuation date).

(iv) Determine the value of the individual's adjusted account balance on the next valuation date by adding (or subtracting, respectively) the amount of any distribution, of a type described in paragraph (c)(2)(ii) of this Q&A b-5 (or the amount of any allocation to the account balance, of a type described in paragraph (c)(2)(ii) of this Q&A b-5), that was made after August 1, 1986, but on or before the next valuation date to (or from) the amount in paragraph (c)(2)(iii) of this Q&A b-5.

(v) Calculate the weighted average of paragraphs (c)(2)(ii) and (c)(2)(iv) of this Q&A b-5, where the weights applied are the number of complete calendar months separating the applicable valuation date and the applicable next date, respectively, and August 1, 1986.

The grandfather amount on August 1, 1986, attributable to the account balance in the defined contribution plan or the individual retirement plan is the amount in paragraph (c)(2)(v) of this Q&A b-5.

b-6: Q. For purposes of determining the value of accrued benefits in a defined contribution plan or a defined benefit plan on August 1, 1986, are non-vested benefits taken into account?

A. Yes. All accrued benefits, whether or not vested, are taken into account.

b-7: Q. To what extent are benefits payable with respect to an individual under a qualified employer plan or an individual retirement plan not taken into account for purposes of calculating the individual's grandfather amount?

A. (a) *Exclusions.* The following benefits payable with respect to an individual are not taken into account for purposes of this calculation:

(1) Benefits attributable to investment in the contract as defined in sec-

tion 72(f). However, amounts attributable to deductible employee contributions (as defined in section 72(o)(5)(A)) are considered part of the accrued benefit.

(2) Amounts that are determinable on August 1, 1986, as payable to an alternate payee who is required to include such amounts in gross income (a spouse or former spouse) under a qualified domestic relations order (QDRO) within the meaning of section 414(p).

(3) Amounts that are attributable to IRA contributions that are distributed pursuant to section 408(d) (4) or (5).

(b) *Alternate payee.* Under a QDRO described in paragraph (a)(2) of this Q&A b-7, amounts are considered part of the accrued benefit of the alternate payee for purposes of calculating the value of the alternate payee's accrued benefit on August 1, 1986. Similarly, such amounts are used by the alternate payee to compute excess distributions.

b-8: Q. What adjustments to the grandfather amount are necessary to take into account rollovers from one qualified employer plan or individual retirement plan to another such plan?

A. (a) *Rollovers outstanding on valuation date.* Generally, rollovers between plans result in adjustment to the grandfather amounts under the rules in Q&A b-5 of this section. However, if a rollover amount is distributed from one plan on or before an applicable valuation date of such plan and is rolled over into the receiving plan after the receiving plan's applicable valuation date and if these events result in an inappropriate duplication or omission of the rollover amount, then an adjustment to the grandfather amount must be made to remove the duplication or omission. The Commissioner may provide necessary rules concerning this adjustment.

(b) *Valuation.* If the rollover amount described in paragraph (a) of this Q&A b-8 is in a form of property other than cash, the property of which the outstanding rollover consists is valued as of the date the rollover contribution is received by the transferee qualified employer plan or individual retirement plan and that value is the amount of the rollover. If the outstanding rollover is in the form of cash, the amount

of the cash is the amount of the roll-over.

b-9: Q. What is the form of the grandfather benefit under a defined benefit plan and how is it valued?

A. (a) *Benefit form.* The grandfather amount under a defined benefit plan is determined on the basis of the form of benefit (including any subsidized form of benefit such as a subsidized early retirement benefit or a subsidized joint and survivor annuity) provided under the plan as of August 1, 1986 that has the greatest present value as determined in paragraph (b) of this b-9. If the plan provides a subsidized joint and survivor annuity, for purposes of determining the grandfather amount, it will be assumed that an unmarried individual is married and that the individual spouse is the same age as the individual. Assumptions as to future withdrawals, future salary increases or future cost-of-living increases are not permitted.

(b) *Value of grandfather amount.* The grandfather amount under a defined benefit plan is the present value of the individual's benefit form determined under paragraph (a) of this Q&A b-9. Thus, the benefit form is reduced to reflect its value on the applicable valuation date. The present value of the benefit form on August 1, 1986, or the applicable date, is computed using the factors specified under the terms of the plan as in effect on August 1, 1986, to calculate a single sum distribution if the plan provides for such a distribution. If the plan does not provide for such a distribution form, such present value is computed using the interest rate and mortality assumptions specified in § 20.2031-7 of the Estate Tax Regulations.

b-10: Q. Is the plan administrator (or trustee) of a qualified plan (or individual retirement account) required to report to an individual the value of the individual's benefit under the plan as of August 1, 1986?

A. (a) *Request required.* No report is required unless the individual requests a report and the request is received before April 15, 1989. If requested, the plan administrator (or trustee or issuer) must report to such individual the value of the individual's benefit under the plan as of August 1, 1986, de-

termined in accordance with Q&A b-5 through b-9 of this section. Such report must be made within a reasonable time after the individual's request but not later than July 15, 1989.

(b) *Other rules.* Alternate payees must make their own request for valuation reports. Any report furnished to an employee who has an alternate payee with respect to the plan must include the separate values attributable to each such individual. Any report furnished to an alternate payee must include only the value attributable to the alternate payee. Reports may be furnished to individuals even if no request is made. Individuals must keep records of the reports received from plans or IRAs in order to substantiate all grandfather amounts.

(c) *Authority.* The rules in this Q&A are provided under the authority in section 6047(d).

b-11: Q. How is the portion of a distribution that is treated as a recovery of an individual's grandfather amount as described in b-1 of this section to be calculated?

A. (a) *General rule.* All distributions received between August 1 and December 31, 1986, inclusive, are treated as a recovery of a grandfather amount. The portion of distributions received after December 31, 1986, that is treated as a recovery of the grandfather amount is determined under either the discretionary method or the attained age method. An amount that is treated as a recovery of grandfather benefits is applied to reduce the initial grandfather amount that was calculated as of August 1, 1986, on a dollar for dollar basis until the unrecovered amount has been reduced to zero. No other recalculation of the grandfather amount is to be made for a date after August 1, 1986.

(b) *Methods, etc.* The grandfather amount may be recovered by an individual under either the discretionary method or the attained age method. After the individual's total grandfather amount is treated as recovered under either method, the tax on excess distributions and excess accumulations is determined without regard to any grandfather amount.

b-12: Q. Under the discretionary method, what portion of each distribution is treated as a return of the individual's grandfather amount?

A. (a) *Initial percentage.* Under the discretionary method, unless the individual elects in accordance with paragraph (b) below, 10 percent of the total distributions that the individual receives during any calendar year is treated as a recovery of the grandfather amount.

(b) *Acceleration.* The individual may elect to accelerate the rate of recovery to 100 percent of the total aggregate distributions received during a calendar year commencing with any calendar year, including 1987 (acceleration election). In such case, the rate of recovery is accelerated to 100 percent for the calendar year with respect to which the election is made and for all subsequent calendar years.

(c) *Election.* To recover the grandfather amount using the discretionary method, an individual must elect to use such method when making the election to use the special grandfather rule on the Form 5329. (See Q&A b-3 of this section.) The acceleration election must be made for the individual's taxable year beginning with or within the first calendar year for which such election is made and must be filed with the individual's income tax return for that year. Such acceleration election may also be made or revoked retroactively on an amended return for such year. However, the acceleration election may not be made after the individual's death other than with the individual's final income tax return or with a return for a prior year for which a return was not filed before the individual's death. Thus, the acceleration election may not be made on an amended return filed after the individual's death for a year for which a return was filed before the individual's death. The preceding two sentences shall not apply to deaths occurring in 1987 or 1988. The estate is entitled to use the remaining grandfather amount to determine if there is an excess accumulation. See Q&A d-3 of this section. The acceleration election shall be made on such form and in such manner as the Commissioner prescribes in a manner consistent with the rules of this section.

b-13: Q. Under the attained age method, what portion of each distribution is treated as a return of the individual's grandfather amount?

A. Under the attained age method, the portion of total distributions received during any year that is treated as a recovery of an individual's grandfather amount is calculated by multiplying the individual's aggregate distributions for a calendar year by a fraction. The numerator of the fraction is the difference between the individual's attained age in completed months on August 1, 1986, and the individual's attained age in months at age 35 (420 months). The denominator of the fraction is the difference between the individual's attained age in completed months on December 31 of the calendar year and the individual's attained age in months at age 35 (420 months). An individual whose 35th birthday is after August 1, 1986, may not use the attained age method.

b-14: Q. How is the 15 percent tax with respect to excess distributions for a calendar year calculated by an individual who has elected to use the special grandfather rule?

A. The calculation of the excise tax may be illustrated by the following examples:

Example 1. (a) An individual (A) who participates in two retirement plans, a qualified defined contribution plan and a qualified defined benefit plan, has a total value of accrued benefits on August 1, 1986 under both plans of \$1,000,000. Because this amount exceeds \$562,500, A is eligible to elect to use the special grandfather rule to calculate the portion of subsequent distributions that are exempt from tax. A elects to use the discretionary grandfather recovery method and attaches a valid election to the 1987 income tax return. A does not elect to accelerate the rate of recovery for 1987. On October 1, 1986, A receives a distribution of \$200,000. On February 1, 1987, A receives a distribution of \$45,000 and, on November 1, 1987, receives a distribution of \$200,000. The 15 percent excise tax applicable to aggregate distributions in 1987 is calculated as follows:

- (1) Value of grandfather amount on 8/1/86\$1,000,000
- (2) Grandfather amounts recovered in 1986 but after 8/1/86\$200,000
- (3) Value of grandfather amount on 12/31/86 ((1) - (2))\$800,000
- (4) Grandfather recovery percentage10%
- (5) Distributions between 1/1/87 and 12/

31/87 (\$45,000×\$200,000).....	\$245,000
(6) Portion of (5) exempt from tax ((4)×(5)).....	\$24,500
(7) Amount potentially subject to tax ((5) - (6)).....	\$220,500
(8) Portion of aggregate distributions in excess of \$112,500 (\$45,000×\$200,000 - \$112,500).....	\$132,500
(9) Amount subject to tax (lesser of (7) and (8)).....	\$132,500
(10) Amount of tax (15% of (9)).....	\$19,875
(11) Remaining undistributed value of grandfather amount as of 12/31/87 ((3) - (6)).....	\$775,500

(b) In 1988, A receives no distributions from either plan. On February 1, 1989, A receives a distribution of \$300,000 and on December 31, 1989, receives a distribution of \$75,000. A makes a valid acceleration election for the 1989 taxable year, whereby A accelerates the rate of grandfather recovery that will apply for calendar years after 1988 to 100 percent. Assume the annual threshold amount for the 1989 calendar year is \$125,000 (i.e., 112,500 indexed). The 15 percent excess tax applicable to distributions in 1989 is calculated as follows:

(1) Value of grandfather amount on 8/ 1/86.....	\$775,500
(2) Grandfather recovery percentage designated for 1989 calendar year	100%
(3) Distributions between 1/1/89 and 12/ 31/89 (\$300,000×\$75,000).....	\$375,000
(4) Portion of (3) exempt from tax (2)×(3).....	\$375,000
(5) Amount potentially subject to tax ((3) - (4)).....	\$0
(6) Portion of aggregate distributions in excess of \$125,000 (\$300,000×\$75,000 - \$125,000).....	\$250,000
(7) Amount subject to tax (lesser of (5) and (6)).....	\$0
(8) Amount of tax (15% of (7)).....	\$0
(9) Remaining undistributed value of grandfather amount as of 12/31/89 ((1) - (4)).....	\$400,500

The entire amount of any distribution for subsequent calendar years will be treated as a recovery of the grandfather amount and applied against the grandfather amount until the unrecovered grandfather amount is reduced to zero.

Example 2. The facts are the same as in *Example 1* except that A elects to use the attained age recovery method and A makes a valid election for the 1987 taxable year. Further assume that A's attained age in months on August 1, 1986 is 471 months and on December 31, 1987, is 488 months. The 15 percent excise tax applicable to aggregate distributions in 1987 is calculated as follows:

(1) Value of grandfather amount on 8/ 1/86.....	\$1,000,000
(2) Grandfather amounts recovered in 1986 but after 8/1/86.....	\$200,000

(3) Value of grandfather amount on 12/ 31/86 ((1) - (2)).....	\$800,000
(4) Completed months of age in excess of 420 on 8/1/86.....	51
(5) Completed months of age in excess of 420 on 12/31/87.....	68
(6) Grandfather fraction as of 12/31/86 ((4) divided by (5)).....	3/4
(7) Distributions between 1/1/87 and 12/ 31/87 (\$45,000 + \$200,000).....	\$245,000
(8) Portion of (7) exempt from tax ((6)×(7)).....	\$183,750
(9) Amount potentially subject to tax ((7) - (8)).....	\$61,250
(10) Portion of aggregate distributions in excess of \$112,500 (\$45,000 + \$200,000 - \$112,500).....	\$132,500
(11) Amount subject to tax (lesser of (9) and (10)).....	\$61,250
(12) Amount of tax (15% of (11)).....	\$9,187
(13) Unrecovered grandfather amount as of 12/31/87 ((3) - (8)).....	\$616,250

c. Special Rules

c-1: Q. How is the excise tax computed if a person elects special tax treatment under section 402 or 403 for a lump sum distribution?

A. (a) General rule—(1) Conditions. Section 4981A(c)(4) provides for a special tax computation that applies to an individual in a calendar year if the individual receives distributions that include a lump sum distribution and the individual makes certain elections under section 402 or 403 with respect to that lump sum distribution (lump sum election).

(2) *Lump sum election.* A lump sum election includes an election of (i) 5-year income averaging under section 402(e)(4)(B); (ii) phaseout capital gains treatment under sections 402(a)(2) or 403(a)(2) prior to their repeal by section 1122(b) of TRA '86 and as permitted under section 1122(h)(4) of TRA '86; (iii) grandfathered long-term capital gains under sections 402(a)(2) and 403(a) prior to such repeal and as permitted by section 1122(h)(3) of TRA '86; and (iv) grandfathered 10-year income averaging under section 402(e) (including such treatment under a section 402(e)(4)(L) election) prior to amendment by section 1122(a) of TRA '86 and as permitted by section 1122(h)(3)(A)(ii) and (5) of the TRA '86.

(3) *Special tax computation.* (i) If the conditions in paragraph (a)(1) of this Q&A c-1 are satisfied for a calendar year, the rules of this subparagraph

(a)(3) apply for purposes of determining whether there are excess distributions and tax under section 4981A.

(ii) All distributions are divided into two categories. These two categories are the lump sum distribution and other distributions. Whether or not a particular distribution is a distribution subject to section 4981A and is in either category is determined under the rules in section 4981A and this section. Thus, the exclusions under section 4981A(c)(2) and Q&A a-4(a) of this section apply here. For example, a distribution that is a tax-free recovery of employee contributions is not in either category.

(iii) The excise tax under section 4981A(c)(1) is computed in the normal manner except that (A) it is the sum of the otherwise applicable taxes determined separately for the two categories of excess distributions and (B) a different amount (threshold amount) is subtracted from the distributions in each category in determining the amount of the excess distributions. The threshold amount that is subtracted from the portion of the distributions that is not part of the lump sum distribution is the applicable threshold amount, determined without regard to section 4981A(c)(4) and the lump sum election. Thus, the threshold amount subtracted from the amount in this category is either the \$150,000 amount or the \$112,500 amount (indexed). The threshold amount that is subtracted from the amount of the lump sum distribution is 5 times the applicable threshold amount as described above. Thus, the threshold amount subtracted from the lump sum distribution is \$750,000 or 5 times \$112,500 indexed (initially \$562,500).

(b) *Grandfather rule*—(1) *In general.* This paragraph (b) provides special rules where an individual makes both the grandfather election described in section 4981A(c)(5) and the lump sum election described in paragraph (a) of this Q&A c-1. See Q&A b-11 through 14 for other rules that apply to such grandfather election.

(2) *Discretionary method.* If the individual uses the discretionary method, described in Q&As b-11 and 12 of this section, the applicable threshold amount is \$112,500 (indexed). Under this method, the grandfather amount is re-

covered at a 10 percent or 100 percent rate in any calendar year and is offset separately against distributions in each category of distributions at the appropriate rate. If, for any calendar year, distributions are received in both categories and the total of the appropriate percentage (10 percent or 100 percent) of the distributions in each category exceed the unrecovered grandfathered amount, then such grandfather amount must be recovered ratably from the distributions in each category. This rule applies even if the distributions in one category are less than the threshold amount for that category and the distributions in the other category exceed the threshold amount for that category.

(3) *Attained age method.* If the individual uses the attained age method, described in Q&As b-11 and 13 of this section, the threshold amount is \$112,500 (indexed). Under this method, to determine the portion of the distributions in each category that is treated as a recovery of the grandfather amount, the fraction described in Q&A b-13 of this section is applied separately to the distributions in each category of distributions. If, for any calendar year, distributions are received in both categories and the total of the amounts of the distributions in each category that are treated as a recovery of the grandfather amount exceeds that undercovered grandfather amount, then such grandfather amount must be recovered ratably from the distributions in each category. This rule applies even if the distributions in one category are less than the threshold amount for that category and the distributions in the other category exceed the threshold amount for that category.

(c) *Amount in lump sum category.* All amounts received from the employer that are required to be distributed to the individual in order to make a lump sum election described in paragraph (a) of this Q&A c-1 are included in the lump sum category. Amounts are in the lump sum category even though they are not subject to income tax under the election. Thus, for example, the following amounts would be in the lump sum category: (1) Appreciation on employer securities received as part of

a distribution for which a lump sum treatment is elected; and (2) amounts that are phased out when section 1122 of TRA '86 is elected. However, accumulated deductible employee contributions under the plan (within the meaning of section 72(o)(5)) are in the nonlump sum category.

(d) *Examples.* The rules in this Q&A c-1 are illustrated by the following examples:

Example (1). (a) On January 1, 199X, individual A who is age 65 and is a calendar year taxpayer receives a lump sum distribution described in section 402(e)(4)(A) from a qualified employer plan (Plan X). A receives no other distribution in 199X. A elects 5-year income averaging under section 402(e)(4)(B) and also elects section 402(e)(4)(L) treatment (treating pre-74 participation as post-1973 participation) on A's income tax return for 199X. Thus, A also makes the lump sum election described in paragraph (a)(2), above. For 199X, the \$112,500 threshold amount indexed is \$125,000. A does not make a grandfather election so that A's threshold amount is \$150,000.

(b) A's distribution from Plan X consists of cash in the amount of \$800,000. A has a section 72(f) investment in the contract. A has over the years made after tax contributions to Plan X of \$50,000. A's distributions subject to section 4981A equal \$750,000 because of the exclusion of A's \$50,000 after-tax contributions.

(c) A's distributions consist solely of amounts in the lump sum category. A's threshold amount equals \$750,000 under the rules of this paragraph (a)(iii), above, (5 times \$150,000). Because A's threshold amount (\$750,000) equals the amount of A's distribution from Plan X (\$750,000) no part of A's distribution from Plan X is treated as an excess distribution subject to the 15-percent excise tax.

Example (2). (a) Assume the same facts as in *Example (1)*, except that A receives an additional distribution from an individual retirement plan described in section 408(a) (IRA Y) in 199X of \$150,000. A has made no nondeductible contributions to IRA Y and all of the \$150,000 is a distribution subject to section 4981A.

(b) A's distributions consist of two categories, the lump sum category (Plan X \$750,000) and the other than lump sum category (IRA Y \$150,000). A separate threshold amount is subtracted from A's IRA Y distribution. This threshold amount equals \$150,000 under the rules of this paragraph (a)(3), above, the same initial threshold amount that is applied against the lump sum prior to the multiplication by 5). Because A's threshold amount (\$150,000) equals the amount of A's distribution from IRA Y

(\$150,000), no part of A's distribution from IRA Y would be treated as an excess distribution subject to the 15-percent excise tax.

Example (3). (a) Assume the same facts as in *Example (2)*, except that A's distribution is \$825,000 from Plan X, before reduction of \$50,000 for employee contributions, instead of \$800,000, so that A's distribution subject to section 4981A from Plan X is \$775,000. A made a valid grandfather election. Therefore, the applicable threshold amount is \$125,000 (\$112,500 indexed for 199X). A's unrecovered grandfather amount as of the end of the year preceding 199X is \$1,000,000 (A had a benefit under another retirement plan (Plan Z) on August 1, 1986, and A's account balance under Plan Z, which is a stock bonus plan, is \$6,000,000 on January 1, 199X.) A also made a valid election of the discretionary method to recover A's grandfather amount.

(b) If A recovers A's grandfather amount in 199X at the 10 percent rate, 10 percent of A's distributions that are in the lump sum category (Plan X \$775,000) is treated as a recovery of A's grandfather amount. Similarly, 10 percent of A's distributions that are in the other than lump sum category (IRA Y \$150,000) is treated as a recovery of A's grandfather amount. Thus, A's grandfather amount is reduced by \$92,500 (\$77,500 Plan X and \$15,000 IRA Y) for the 199X calendar year and is \$907,500 on January 1 of the year following 199X. Because the amounts of the distributions in each category that are treated as a recovery of grandfather amount are less than the applicable threshold amount for each category (\$625,000 Plan X, \$125,000 IRA Y), the recovery of the grandfather amount does not affect the calculations of the 199X excise tax.

(c) Because A's distribution from IRA Y of \$150,000 exceeds A's threshold amount of \$125,000 (\$112,500 indexed) applicable to nonlump sum distributions by \$25,000 and A's distribution subject to section 4981A from Plan X of \$775,000 exceeds A's threshold amount of \$625,000 (5X\$125,000) applicable to lump sums by \$150,000, A is subject to the 15-percent excise tax. A's tax under section 4981A is \$26,250 (15 percent of \$25,000 plus 15 percent of \$150,000).

Example (4). (a) Assume the same facts as in *Example (3)* except that A makes a valid acceleration election under the discretionary method with respect to A's grandfather amount of \$1,000,000 for calendar year 199X.

(b) Because A's grandfather amount on January 1, 199X (\$1,000,000) equals or exceeds A's distribution subject to section 4981A (\$925,000) for 199X, no part of A's distribution from Plan X or IRA Y would be treated as excess distribution subject to the 15-percent excise tax.

(c) A's distributions subject to 4981A from Plan X of \$775,000 and from IRA Y of \$150,000 are offset 100 percent by A's grandfather

amount of \$1,000,000. Therefore, A's grandfather amount on January 1 of the year following 199X is \$75,000 (\$1,000,000 minus \$925,000). This \$75,000 would be required to be offset 100 percent against any distributions received in that year.

Example (5). (a) Assume the same facts as in *Example (4)*, except that A's distribution subject to section 4981A from Plan X, after reduction of the \$50,000 for employee contributions, is \$1,000,000 and from IRA Y is \$125,000 (equal to the threshold amount), totaling \$1,125,000.

(b) Because the sum of the amount received in the lump sum category and the other than lump sum category of distributions is greater than the grandfather amount (\$1,000,000), the grandfather amount must be allocated to each separate category on the basis of the ratio of the amount received in each category to the sum of these amounts. Thus, \$888,889 (\$1,000,000 X (\$1,000,000 divided by \$1,125,000)) is allocated to the lump-sum category and \$111,111 (\$1,000,000 X (\$125,000 divided by \$1,125,000)) is allocated to the other than lump sum category. A's distributions of \$1,000,000 in the lump sum category are reduced by \$888,889, the greater of \$625,000 (the threshold amount) or \$888,889 (grandfather amount), and equal \$111,111. A's excise tax is \$16,666 (15 percent of \$111,111). A owes no excess distribution tax on the \$125,000 received from IRA Y because it is fully offset by the threshold amount of \$125,000.

(c) Because A's distribution subject to section 4981A for the year of \$1,125,000 (\$1,000,000 plus \$125,000) exceeds A's grandfather amount on January 1, 199X of \$1,000,000, A's grandfather amount is zero for all subsequent calendar years.

c-2: Q. Must retirement plans be amended to limit future benefits accruals so that the amounts that are distributed would not be subject to an excise tax under section 4981A?

A. No. A qualified employer plan need not be amended to reduce future benefits so that the amount of annual aggregate distributions are not subject to tax under section 4981A. Section 415 does, however, require plan provisions that limit the accrual of benefits and contributions to specified amounts. The operation of the excise tax of section 4981A is independent of plan qualification requirements limiting benefits and contributions under qualified plans.

c-3: Q. Is a plan amendment reducing accrued benefits a permitted method of avoiding the excise tax?

A. No. Accrued benefits may not be reduced to avoid the imposition of the

excise tax. Such reduction would violate employer plan qualification requirements, including section 411(d)(6).

c-4: Q. To what extent is the 15 percent section 4981A tax reduced by the 10 percent section 72(t) tax?

A. (a) *General rule.* The 15 percent tax on excess distributions may be offset by the 10 percent tax on early distributions to the extent that the 10 percent tax is applied to excess distributions. For example, assume that individual (A), age 56, receives a distribution of \$200,000 from a qualified employer plan (Plan X) during calendar year 1987. Further, assume that the entire distribution is subject to the 10-percent tax of section 72(t). A tax of \$20,000 (10% of \$200,000) is imposed on the distribution under section 72(t). Assuming that the distribution is not a lump sum distribution eligible for special tax treatment under section 402, part of the distribution is subject to tax under section 4981A. If A does not elect the special grandfather rule, A's dollar limitation is \$150,000 and the amount of \$200,000 distribution that is an excess distribution is \$50,000 (\$200,000-\$150,000). The 15 percent tax is \$7,500 (15% of \$50,000). The portion of the \$20,000 section 72(t) tax on early distributions that is attributable to the excess distribution is \$5,000 (10% of \$50,000). This amount is credited against the section 4981A tax. Therefore, the total tax imposed on the distribution under both provisions is \$22,500 (\$20,000 + (\$7,500-\$5,000)).

(b) *Example.* (1) If some, but not all, distributions made for a calendar year are subject to the section 72(t) tax, the offset is applied only to the extent that the section 72(t) tax applies to amounts that exceed the applicable threshold amount for that calendar year. For example, assume that during 1987 individual B receives a distribution of \$40,000 that is not subject to the 10 percent section 72(t) tax and a separate distribution of \$160,000 that is subject to the 10 percent section 72(t) tax. A tax of \$16,000 (10% of \$160,000) is imposed by section 72(t). Excess distributions for the year, assuming B does not elect the special grandfather rule, are \$50,000 (\$40,000 + \$160,000-\$150,000). The tax under section 4981A is \$7,500 (15% of \$50,000). For purposes of determining

the extent to which the 10 percent tax is applied to excess distributions, the only amounts subject to the 10 percent tax that are taken into account are distributions in excess of \$150,000 (or if greater, the \$112,500 (indexed) threshold for the year). The amount of distributions for 1987 to which the 10 percent tax is applicable (\$160,000) exceeds \$150,000 by \$10,000. Thus, the portion of the section 72(t) tax of \$16,000 that is attributable to excess distributions equals \$1,000 (10 percent of \$10,000). This amount is credited against the section 4981A tax. The total tax payable under the provisions of sections 72(t) and 4981A is \$22,500 (\$16,000 + (\$7,500-\$1,000)).

(c) *Net unrealized appreciation.* A distribution consisting of net unrealized appreciation of employer securities that is excluded from gross income is not subject to section 72(t) and, therefore, there is no section 72(t) tax on such distribution that may be used to offset the tax on excess distributions.

c-5: *Q.* If a distribution that is subject to both the 10 percent tax on early distributions from qualified plans imposed under section 72(t) and the 15 percent tax on excess distributions imposed under section 4981A is received by an individual who elects to calculate the 15 percent tax using the special grandfather rule, how is the offset of the 10 percent tax imposed under section 72(t) calculated?

A. The section 4981A tax is reduced only by the amount of the 10 percent tax that is attributable to the portion of the distribution to which the section 4981A tax applies. For example, assume that (a) an individual (A), age 57, receives during 199X a distribution from a qualified plan of \$325,000 that is subject to the 10 percent section 72(t) tax; (b) the distribution is not a lump sum distribution and is subject to the 15 percent excise tax imposed by section 4981A; (c) A has elected to use the special grandfather rule; and (d) A accelerates the rate of recovery of the remaining grandfather amount of \$250,000 so that only \$75,000 of this distribution is subject to the section 4981A tax. Thus, the section 4981A tax is \$11,250 (15% of \$75,000). The portion of the section 72(t) 10 percent tax that is offset against the section 4981A tax of \$11,250 is limited to \$7,500 (10% of \$75,000), the section 72(t)

tax on the amount of distributions after taking into account the reduction under the grandfather rule.

c-6: *Q.* When do distributions become subject to the excise tax under section 4981A?

A. (a) *General rule.* Excess distributions made after December 31, 1986, are subject to the excise tax under section 4981A.

(b) *Transitional rule—(1) Termination.* Distributions prior to January 1, 1988, made on account of certain terminations of a qualified employer plan are not subject to tax under section 4981A. For a plan termination to be eligible for this transitional rule, the plan termination must occur before January 1, 1987. For purposes of applying the rules of section 4981A (except the reporting requirements), any such distribution is treated as if made on December 31, 1986. The distribution of an annuity contract is not an excepted distribution. See Q&A a-5 of this section.

(2) *Lump sum distributions.* A lump sum distribution that an individual who separates from service in 1986 receives in calendar year 1987 before March 16 is treated as a distribution received in 1986 if such individual elects to treat it as received in 1986 under the provisions of section 1124 of TRA '86. Thus, such a qualifying section 1124 distribution is not subject to tax under section 4981A for 1987. For purposes of applying the rules of section 4981A, the amount attributable to such distribution is included in the individual's August 1, 1986 accrued benefit and such distribution is treated as if made on December 31, 1986.

(3) *Grandfather amount recovery.* If an individual described in this paragraph elects the special grandfather rule, the entire amount of distributions described in subparagraph (1) or (2) of this paragraph (b) is treated as a recovery of the individual's grandfather amount because it is treated as received on December 31, 1986. Thus, the individual's outstanding grandfather amount as of the date of the distribution is reduced by the amount of such distribution.

c-7: *Q.* How is the tax on excess distributions or on excess accumulations under section 4981A reported?

A. (a) *Tax on excess distributions.* An individual liable for tax on account on excess distributions under section 4981A must complete Form 5329 and attach it to his income tax return for the taxable year beginning with or within the calendar year during which the excess distributions are received. The amount of the tax is reported on such form and in such manner as prescribed by the Commissioner.

(b) *Tax on excess accumulations—(1) General rule.* If, with respect to the estate of any individual, there is a tax under section 4981A(d) on account of the individual's excess accumulations, the amount of such tax is reported on Schedule S (Form 706 or 706NR). Schedule S must be filed on or before the due date under section 6075 including extensions, for filing the estate tax return. The tax under section 4981A(d) must be paid by the otherwise applicable due date for paying the estate tax imposed by chapter 11 even if, pursuant to section 6018(a), no return is otherwise required with respect to the estate tax imposed by chapter 11.

(2) *Earliest due date.* Notwithstanding paragraph (b)(1) of this c-7, the due date for filing Schedule S (Form 706) and paying the tax on excess accumulations under section 4981A(d) is not earlier than February 1, 1988. Thus, with respect to the estates of individuals dying in January through April of 1987, the due date for filing Schedule S (Form 706) and paying any tax owed under section 4981A(d) is not earlier than February 1, 1988, even if the due date for filing the Schedule 706 and paying the estate tax imposed by chapter 11 is an earlier date. Further, no interest or penalties will be charged for failure to pay any tax on excess accumulations under section 4981A before January 31, 1988.

c-8: *Q.* Does the fact that the benefits under a qualified retirement plan or individual retirement account are community property affect the determination of the excise tax under section 4981A?

A. Generally, no. The operation of community property law is disregarded in determining the amount of aggregate annual distributions. Thus, the excise tax under section 4981A is computed without regard to the spouse's

community property interest in the individual's or decedent's distributions or accumulation. Also, any reporting to the individual by a trustee, must be done on an aggregate basis without regard to the community property law.

d. Excess Accumulations

d-1: *Q.* To what extent does section 4981A increase the estate tax imposed by chapter 11 with respect to the estates of any decedents?

A. Section 4981A(d) provides that the estate tax imposed by chapter 11 with respect to the estate of any decedent is increased by an amount equal to 15 percent of the decedent's excess accumulation. See Q&A d-2 through d-7 of this section for rules for determining the decedent's excess accumulation. See Q&A d-8 of this section concerning credits under section 2010 through 2016. See Q&A d-9 of this section for examples illustrating the determination of the increase in estate tax under section 4981A(d).

d-2: *Q.* How is the amount of an decedent's excess accumulation determined?

A. (a) *General rule.* A decedent's excess accumulation is the excess of (1) the aggregate value of the decedent's interests in all qualified employer plans and individual retirement plans (decedent's aggregate interest) as of the date of the decedent's death over (2) an amount equal to the present value of a hypothetical life annuity determined under Q&A d-7 of this section. If the personal representative for the individual's estate elects to value the property in the gross estate under section 2032, the applicable valuation date prescribed by section 2032 shall be substituted for the decedent's date of death.

(b) *Other rules.* See Q&A d-3 and d-4 of this section if the decedent or, where appropriate, the decedent's personal representative validly elects the special grandfather rule and has any unused grandfather benefit as of the date of his death. See Q&A d-5 and d-6 of this section to determine the decedent's aggregate interest.

d-3: *Q.* Does the special grandfather rule apply for purposes of determining the amount of the decedent's excess accumulation?

A. Yes. If a decedent prior to death (or the decedent's personal representative after death) makes an election that satisfied the procedures in Q&A b-3 of this section, the special grandfather rule applies.

d-4. Q. How is the decedent's excess accumulation determined if the special grandfather rule applies?

A. If the special grandfather rule applies, the decedent's excess accumulation is the excess of (a) the decedent's aggregate interest (determined under Q&A d-5 of this section) over (b) the greater of (1) the decedent's remaining unrecovered grandfather amount as of the date of the decedent's death, or (2) an amount equal to the present value of a hypothetical life annuity under Q&A d-7 of this section.

d-5. Q. How is the value of the decedent's aggregate interest as of the applicable valuation date under Q&A d-2 determined?

A. (a) *Method of valuation.* The value of the decedent's aggregate interest on the decedent's date of death is determined in a manner consistent with the valuation of such interests for purposes of determining the individual's gross estate for purposes of chapter 11. If the personal representative for an individual's estate subject to estate tax elects to value the property in the gross estate under section 2032, the decedent's aggregate interest is valued in a manner consistent with the rules prescribed by section 2032 (and other relevant estate tax sections). No adjustments provided in chapter 11 in valuing the gross estate are made. Thus, there is no adjustment under section 2057 (relating to the sale of certain employer securities).

(b) *Amounts included.* Generally, all amounts payable to beneficiaries of the decedent under any qualified employer plan (including amounts payable to a surviving spouse under a qualified joint and survivor annuity or qualified pre-retirement survivor annuity) or individual retirement plan, whether or not otherwise included in valuing the decedent's gross estate, are considered to be part of the decedent's interest in such plan.

(c) *Rollover after death.* If any amount is distributed from a qualified employer plan or individual retirement

plan within the 60-day period ending on the decedent's date of death and is rolled over to an IRA after such date but within 60 days of the date distributed, the decedent's aggregate interest is increased by the amount rolled over, valued as of the date received by the IRA.

d-6. Q. Are there any reductions in the decedent's aggregate interest?

A. The decedent's aggregate interest is reduced by the following:

(a) *Amount payable to alternate payee.* The amount of any portion of the deceased individual's interest in a qualified employer plan that is payable to an alternate payee in whose income the amount is includible under a qualified domestic relations order within the meaning of section 414(p) (QDRO). However, such portion must be taken into account in determining the excess distribution or the excess accumulation upon the death of such alternate payee for purposes of determining if there is a tax under section 4981A(a) or an increase in the estate tax under section 4981A(d) with respect to such alternate payee.

(b) *Investment in the contract.* The amount of the deceased individual's unrecovered investment, within the meaning of section 72(f), in any qualified employer plan or individual retirement plan.

(c) *Life insurance proceeds.* The excess of any amount payable by reason of the death of the individual under a life insurance contract held under a qualified employer plan over the cash surrender value of such contract immediately before the death of such individual (the amount excludible from income by reason of section 101(a)). Amounts excludible from gross income because of section 101(b) do not reduce the decedent's aggregate interest.

(d) *Interest as a beneficiary.* The amount of the deceased individual's interest in a qualified retirement plan or individual retirement plan by reason of the death of another individual.

d-7. Q. How is the present value of the hypothetical life annuity determined?

A. (a) *General rule.* The hypothetical life annuity is a single life annuity contract that provides for equal annual annuity payments commencing on the

decedent's date of death for the life of an individual whose age is the same as the decedent's determined as of the date of the decedent's death. The amount of each annual payment is equal to the greater of \$150,000 (unindexed) and \$112,500 (as indexed until the date of death). If the decedent elected (or the decedent's personal representative elects) the special grandfather rule, the amount of each annual payment is \$112,500 (as indexed until the date of death) even if there is no remaining grandfather amount.

(b) *Determination of age.* The decedent's age as of the decedent's date of death for purposes of valuing the hypothetical life annuity is the decedent's attained age (in whole years) as of the decedent's date of death. For example, if the decedent was born on February 2, 1930, and died on August 3, 1990, the decedent's age for purposes of valuing the hypothetical life annuity is 60.

(c) *Interest rate assumptions.* The present value of the single life annuity described above must then be calculated using the interest rate and mortality assumptions in § 20.2031-7 of the Estate Tax Regulations in effect on the date of death.

d-8: Q. Are any credits, deductions, exclusions, etc. that apply for estate tax purposes allowable as an offset against the excise tax under section 4981A(d) for excess accumulations?

A. No. No credits, deductions, exclusions, etc. that apply for estate tax purposes are allowed to offset the tax imposed under section 4981A(d). Thus, no credits under section 2010 through 2016 or other reductions permitted by Chapter 11 are allowable against the tax under section 4981A(d) for excess accumulations. For example, no credits are allowable for the unified credit against the estate tax, for state death taxes, or for gift taxes.

d-8A. Q. Is the estate liable for the excise tax of 15 percent on the amount of the decedent's excess accumulations?

A. Yes. In all events, the estate is liable for the excise tax of 15 percent on the amount of the decedent's excess accumulations. Transferee liability rules under chapter 11 do apply, however. Similarly, the reimbursement provisions of section 2205 also apply. Addi-

tionally, the rules generally applicable for purposes of determining the apportionment of the estate tax apply to the apportionment of the excise tax under section 4981A(d). Thus, the decedent's will or the applicable state apportionment law may provide that the executor is entitled to recover the tax imposed under section 4981A(d) attributable to any property from the beneficiary entitled to receive such property. However, absent such a provision in the decedent's will or in the applicable state apportionment law, the executor is not entitled to recover the tax imposed under section 4981A(d) attributable to any property from the beneficiary entitled to receive such property.

d-9: Q. How is the additional tax computed with respect to a decedent's estate under section 4981A(d)?

A. The determination of the additional tax under section 4981A(d) is illustrated by the following examples:

Example 1. (a) An individual (A) dies on February 1, 199X at age 70 and 9 months. As of A's date of death, A has an interest in a defined benefit plan described in section 401(a) (Plan X). Plan X has never provided for employee contributions. A has no section 72 (f) investment in Plan X. A does not have any interest in any other qualified employer plan or individual retirement plan. The alternate valuation date in section 2032 does not apply. A did not elect to have the special grandfather rule apply. A's interest in Plan X is in the form of a qualified joint and survivor annuity. The value of the remaining payments under the joint and survivor annuity as of A's date of death (determined under D-5) is \$2,000,000.

(b) Because A is age 70 and 9 months of A's date of death, A's life expectancy as of A's date of death is calculated using age 70 (A's attained age in whole years on A's date of death). The factor from Table A of § 20.2031-7(f) used to determine the present value of a single life annuity for an individual age 70 is 6.0522. The greater of \$150,000 or \$112,500 indexed for 199X is 150,000. The present value of the hypothetical single life annuity is \$907,830 ($\$150,000 \times 6.0522$).

(c) The amount of A's excess accumulation is \$1,092,170, determined as follows: \$2,000,000 (value of A's interest in Plan X) minus \$907,830 (value of hypothetical single life annuity contract) equals \$1,092,170.

(d) The increase in the estate tax under section 4981A(d) is \$163,825 (15 percent of \$1,092,170).

Example 2. (a) The facts are the same as in *Example 1*, except that A's interest in Plan X consists of the following:

(1) \$2,000,000, value of employer-provided portion of a qualified joint and survivor annuity determined as of A's date of death using the interest and mortality assumptions in § 20.2031-7.

(2) \$200,000, proceeds of a term life insurance contract (no cash surrender value before death).

(3) \$100,000, amount (employer-provided portion) payable to A's former spouse pursuant to a QDRO.

(4) \$100,000, amount of A's investment in Plan X.

(b) The value of A's interest in Plan X for purposes of calculating A's excess accumulation is still \$2,000,000. The proceeds of the term life insurance contract, the amount payable under the QDRO, and the amount of A's investment in Plan X are excluded from such value.

Example 3. (a) The facts are the same as in *Example 1*, except that A elected the special grandfather rule. A's initial grandfather amount was \$1,100,000. As of A's date of death, A had received \$500,000 in distributions that were treated as a return of A's grandfather amount. Thus, A's unused grandfather amount is \$600,000 (\$1,100,000-\$500,000). In 199X, assume that \$112,500 indexed is still \$112,500.

(b) A's excess retirement accumulation is determined as follows: \$2,000,000 minus the greater of (1) \$600,000 or (2) the present value of a period certain annuity of \$112,500 a year for 16 years. The present value of a single life annuity of \$112,500 a year for an individual age 70 is determined as follows: $112,500 \times 6.0522 = 680,827.25$. \$680,827.25 is greater than \$600,000. Thus the amount of the excess retirement accumulation is \$1,319,173 (\$2,000,000 minus \$680,827).

(c) The additional estate tax under section 4981A(d) is \$197,875 (15 percent of \$1,319,173).

Example 4. (a) The facts are the same as in *Example 3* except that, as of A's date of death, A received \$90,000 in distributions that were treated as a return of A's grandfather amount. Thus, A's unused grandfather amount is \$1,010,000 (\$1,100,000-\$90,000).

(b) A's excess retirement accumulation is determined as follows: \$2,000,000 minus the greater of (1) (\$1,010,000 (A's unused grandfather amount) or (2) 680,827.25 (the present value of a single life annuity of \$112,500 a year for an individual age 70). A's unused grandfather amount is greater than the present value of the hypothetical life annuity. Thus, the amount of the excess retirement accumulation is \$990,000 (\$2,000,000-\$1,010,000).

(c) The additional estate tax under section 4981A(d) is \$148,500 (15 percent of \$990,000).

d-10. Q. If a surviving spouse rolls over a distribution from a qualified retirement plan or an individual retirement plan of the decedent to an individual retirement plan (IRA) established in the spouse's own name, is any distribution in a calendar year from the IRA receiving such rollover included in determining the spouse's excess distribution or excess accumulation in such calendar year?

A. (a) *General rule.* If a surviving spouse rolls over a distribution from a qualified retirement plan or an individual retirement plan of the decedent to an individual retirement plan (IRA) established in the spouse's own name with the rollover contribution and no other contributions or transfers are made to the IRA receiving the rollover contribution, distributions from such IRA will be excluded in determining the spouse's excess distributions and the value of the IRA will be excluded in determining the spouse's excess accumulation. If the surviving spouse rolls over a distribution from a qualified retirement plan or IRA of the decedent to an IRA for which the spouse has prior contributions or makes additional contributions to the IRA receiving the distribution, distributions from the IRA will be included in determining the amount of the excess distributions received by the spouse for the calendar year of the distribution and the value of the IRA at the applicable valuation date will be included in determining the spouse's excess accumulation.

(b) *Special rules.* The rule in paragraph (a) of this Q&A d-10 also applies if a surviving spouse elects to treat an inherited IRA (described in section 408(d)(3)(C)(ii)) as the spouse's own IRA as long as the surviving spouse makes no further contributions to such IRA.

(c) *Other beneficiaries.* Rules similar to the rules in paragraphs (a) and (b) shall apply to an individual who elected to treat an IRA as subject to the distribution requirements of section 408(a)(6), prior to amendment by section 521(b) of TRA '84, under § 1.408-2(b)(7)(ii) of the Income Tax Regulations.

d-11. Q. To what estates does the excess tax under section 4981A(d) apply?

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A. The excise tax under section 4981A(d) applies to estates of decedents dying after December 31, 1986.

d-12: Q. Is the aggregate interest reduced by distributions described in paragraph (b)(1) of Q&A c-6 of this section (distributions prior to January 1, 1988, made on account of certain terminations of a qualified employer plan) which are made after the individual's death.

A. Yes, the value of the individual's aggregate interest determined under Q&A d-5 of this section is reduced by distributions described in paragraph (b)(1) of Q&A c-6 of this section which are made after the individual's death.

[T.D. 8165, 52 FR 46750, Dec. 10, 1987; 53 FR 18975, May 26, 1988]

§ 54.6011-1 General requirement of return, statement, or list.

(a) *Minimum funding standards or excess contributions for self-employed individuals and section 403(b)(7)(A) custodial accounts.* Any employer or individual liable for tax under section 4971, 4972 or 4973(a)(2) (for a custodial account under section 403(b)(7)(A)) shall file an annual return on Form 5330 and shall include therein the information required by such form and the instructions issued with respect thereto.

(b) *Tax on prohibited transactions.* Every disqualified person (as defined in section 4975(e)(2)) liable for the tax imposed under section 4975(a) with respect to a prohibited transaction shall file an annual return on Form 5330 and shall include therein the information required by such form and the instructions issued with respect thereto. The annual return on Form 5330 shall be filed with respect to each prohibited transaction and for each taxable year (or part thereof) of the disqualified person in the taxable period (as defined in section 4975(f)(2)) beginning on the date on which such prohibited transaction occurs.

[T.D. 7838, 47 FR 44249, Oct. 7, 1982]

§ 54.6011-1T General requirement of return, statement, or list (temporary).

Every employer liable for the tax imposed under section 4980(a) with respect to an employer reversion (as defined in section 4980(c)(2)) shall file a quarterly

return on Form 5330 and shall include therein the information required by such form and the instructions issued with respect thereto. The quarterly return on Form 5330 shall be filed with respect to employer reversions from each qualified plan (as defined in section 4980(c)(1)).

[T.D. 8133, 52 FR 10563, Apr. 2, 1987]

§ 54.6011-4 Requirement of statement disclosing participation in certain transactions by taxpayers.

(a) *In general.* If a transaction is identified as a *listed transaction* as defined in § 1.6011-4 of this chapter by the Commissioner in published guidance (see § 601.601(d)(2) of this chapter), and the listed transaction involves an excise tax under chapter 43 of subtitle D of the Internal Revenue Code (relating to qualified pension, etc., plans), the transaction must be disclosed in the manner stated in such published guidance.

(b) *Effective date.* This section applies to transactions entered into on or after January 1, 2003.

[T.D. 9046, 68 FR 10170, Mar. 4, 2003]

§ 54.9801-1 Basis and scope.

(a) *Statutory basis.* Sections 54.9801-1 through 54.9801-6, 54.9802-1, 54.9802-1T, 54.9811-1T, 54.9812-1T, 54.9831-1, and 54.9833-1 (portability sections) implement Chapter 100 of Subtitle K of the Internal Revenue Code of 1986.

(b) *Scope.* A group health plan may provide greater rights to participants and beneficiaries than those set forth in these portability sections. These portability sections set forth minimum requirements for group health plans concerning:

(1) Limitations on a preexisting condition exclusion period.

(2) Certificates and disclosure of previous coverage.

(3) Rules relating to creditable coverage.

(4) Special enrollment periods.

(5) Prohibition against discrimination on the basis of health factors.

(c) *Similar requirements under the Employee Retirement Income Security Act and the Public Health Service Act.* Sections 701, 702, 703, 711, 712, 732, and 733 of the Employee Retirement Income