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## **Internal Revenue Code**

# **§ 72 Annuities; certain proceeds of endowment and life insurance contracts.**

### **(a) General rule for annuities.**

#### **(1) Income inclusion.**

Except as otherwise provided in this chapter, gross income includes any amount received as an annuity (whether for a period certain or during one or more lives) under an annuity, endowment, or life insurance contract.

#### **(2) Partial annuitization.**

If any amount is received as an annuity for a period of 10 years or more or during one or more lives under any portion of an annuity, endowment, or life insurance contract—

(A) such portion shall be treated as a separate contract for purposes of this section,

(B) for purposes of applying subsections (b), (c), and (e), the investment in the contract shall be allocated pro rata between each portion of the contract from which amounts are received as an annuity and the portion of the contract from which amounts are not received as an annuity, and

(C) a separate annuity starting date under subsection (c)(4) shall be determined with respect to each portion of the contract from which amounts are received as an annuity.

### **(b) Exclusion ratio.**

#### **(1) In general.**

Gross income does not include that part of any amount received as an annuity under an annuity, endowment, or life insurance contract which bears the same ratio to such amount as the investment in the contract (as of the annuity starting date) bears to the expected return under the contract (as of such date).

**(2) Exclusion limited to investment.**

The portion of any amount received as an annuity which is excluded from gross income under paragraph (1) shall not exceed the unrecovered investment in the contract immediately before the receipt of such amount.

**(3) Deduction where annuity payments cease before entire investment recovered.**

(A) In general. If—

(i) after the annuity starting date, payments as an annuity under the contract cease by reason of the death of an annuitant, and

(ii) as of the date of such cessation, there is unrecovered investment in the contract,

the amount of such unrecovered investment (in excess of any amount specified in subsection (e)(5) which was not included in gross income) shall be allowed as a deduction to the annuitant for his last taxable year.

(B) Payments to other persons. In the case of any contract which provides for payments meeting the requirements of subparagraphs (B) and (C) of subsection (c)(2) , the deduction under subparagraph (A) shall be allowed to the person entitled to such payments for the taxable year in which such payments are received.

(C) Net operating loss deductions provided. For purposes of section 172 , a deduction allowed under this paragraph shall be treated as if it were attributable to a trade or business of the taxpayer.

**(4) Unrecovered investment.**

For purposes of this subsection , the unrecovered investment in the contract as of any date is—

(A) the investment in the contract (determined without regard to subsection (c)(2) ) as of the annuity starting date, reduced by

(B) the aggregate amount received under the contract on or after such annuity starting date and before the date as of which the determination is being made, to the extent such amount was excludable from gross income under this subtitle.

**(c) Definitions.**

**(1) Investment in the contract.**

For purposes of subsection (b) , the investment in the contract as of the annuity starting date is—

(A) the aggregate amount of premiums or other consideration paid for the contract, minus

(B) the aggregate amount received under the contract before such date, to the extent that such amount was excludable from gross income under this subtitle or prior income tax laws.

**(2) Adjustment in investment where there is refund feature.**

If—

(A) the expected return under the contract depends in whole or in part on the life expectancy of one or more individuals;

(B) the contract provides for payments to be made to a beneficiary (or to the estate of an annuitant) on or after the death of the annuitant or annuitants; and

(C) such payments are in the nature of a refund of the consideration paid,

then the value (computed without discount for interest) of such payments on the annuity starting date shall be subtracted from the amount determined under paragraph (1) . Such value shall be computed in accordance with actuarial tables prescribed by the Secretary. For purposes of this paragraph and of subsection (e)(2)(A) , the term "refund of the consideration paid" includes amounts payable after the death of an annuitant by reason of a provision in the contract for a life annuity with minimum period of payments certain, but (if part of the consideration was contributed by an employer) does not include that part of any payment to a beneficiary (or to the estate of the annuitant) which is not attributable to the consideration paid by the employee for the contract as determined under paragraph (1)(A) .

**(3) Expected return.**

For purposes of subsection (b) , the expected return under the contract shall be determined as follows:

(A) Life expectancy. If the expected return under the contract, for the period on and after the annuity starting date, depends in whole or in part on the life expectancy of one or more individuals, the expected return shall be computed with reference to actuarial tables prescribed by the Secretary.

(B) Installment payments. If subparagraph (A) does not apply, the expected return is the aggregate of the amounts receivable under the contract as an annuity.

**(4) Annuity starting date.**

For purposes of this section , the annuity starting date in the case of any contract is the first day of the first period for which an amount is received as an annuity under the contract; except that if such date was before January 1, 1954, then the annuity starting date is January 1, 1954.

**(d) Special rules for qualified employer retirement plans.**

**(1) Simplified method of taxing annuity payments.**

(A) In general. In the case of any amount received as an annuity under a qualified employer retirement plan—

(i) subsection (b) shall not apply, and

(ii) the investment in the contract shall be recovered as provided in this paragraph .

(B) Method of recovering investment in contract.

(i) In general. Gross income shall not include so much of any monthly annuity payment under a qualified employer retirement plan as does not exceed the amount obtained by dividing—

(I) the investment in the contract (as of the annuity starting date), by

(II) the number of anticipated payments determined under the table contained in clause (iii) (or, in the case of a contract to which subsection (c)(3)(B) applies, the number of monthly annuity payments under such contract).

(ii) Certain rules made applicable. Rules similar to the rules of paragraphs (2) and (3) of subsection (b) shall apply for purposes of this paragraph .

(iii) Number of anticipated payments. If the annuity is payable over the life of a single individual, the number of anticipated payments shall be determined as follows:

If the age of the annuitant on the number of anticipated payments is:	The number of anticipated payments is:
Not more than 55	360
More than 55 but not more than 60	310
More than 60 but not more than 65	260
More than 65 but not more than 70	210
More than 70	160.

(iv) Number of anticipated payments where more than one life. If the annuity is payable over the lives of more than 1

individual, the number of anticipated payments shall be determined as follows:

If the combined ages of annuitants are:  
The number is:  
Not more than 110  
410  
More than 110 but not more than 120  
360  
More than 120 but not more than 130  
310  
More than 130 but not more than 140  
260  
More than 140  
210.

(C) Adjustment for refund feature not applicable. For purposes of this paragraph , investment in the contract shall be determined under subsection (c)(1) without regard to subsection (c)(2) .

(D) Special rule where lump sum paid in connection with commencement of annuity payments. If, in connection with the commencement of annuity payments under any qualified employer retirement plan, the taxpayer receives a lump sum payment—

(i) such payment shall be taxable under subsection (e) as if received before the annuity starting date, and

(ii) the investment in the contract for purposes of this paragraph shall be determined as if such payment had been so received.

(E) Exception. This paragraph shall not apply in any case where the primary annuitant has attained age 75 on the annuity starting date unless there are fewer than 5 years of guaranteed payments under the annuity.

(F) Adjustment where annuity payments not on monthly basis. In any case where the annuity payments are not made on a monthly basis, appropriate adjustments in the application of this paragraph shall be made to take into account the period on the basis of which such payments are made.

(G) Qualified employer retirement plan. For purposes of this paragraph , the term “qualified employer retirement plan” means any plan or contract described in paragraph (1) , (2) , or (3) of section 4974(c) .

**(2) Treatment of employee contributions under defined contribution plans.**

For purposes of this section , employee contributions (and any income allocable thereto) under a defined contribution plan may be treated as a separate contract.

**(e) Amounts not received as annuities.**

**(1) Application of subsection.**

(A) In general. This subsection shall apply to any amount which—

(i) is received under an annuity, endowment, or life insurance contract, and

(ii) is not received as an annuity,

if no provision of this subtitle (other than this subsection ) applies with respect to such amount.

(B) Dividends. For purposes of this section , any amount received which is in the nature of a dividend or similar distribution shall be treated as an amount not received as an annuity.

**(2) General rule.**

Any amount to which this subsection applies—

(A) if received on or after the annuity starting date, shall be included in gross income, or

(B) if received before the annuity starting date—

(i) shall be included in gross income to the extent allocable to income on the contract, and

(ii) shall not be included in gross income to the extent allocable to the investment in the contract.

**(3) Allocation of amounts to income and investment.**

For purposes of paragraph (2)(B) —

(A) Allocation to income. Any amount to which this subsection applies shall be treated as allocable to income on the contract to the extent that such amount does not exceed the excess (if any) of—

(i) the cash value of the contract (determined without regard to any surrender charge) immediately before the amount is received, over

(ii) the investment in the contract at such time.

(B) Allocation to investment. Any amount to which this subsection applies shall be treated as allocable to investment in the contract to the extent that such amount is not allocated to income under subparagraph (A) .

**(4) Special rules for application of paragraph (2)(B) .**

For purposes of paragraph (2)(B) —

(A) Loans treated as distributions. If, during any taxable year, an individual—

(i) receives (directly or indirectly) any amount as a loan under any contract to which this subsection applies, or

(ii) assigns or pledges (or agrees to assign or pledge) any portion of the value of any such contract,

such amount or portion shall be treated as received under the contract as an amount not received as an annuity. The preceding sentence shall not apply for purposes of determining investment in the contract, except that the investment in the contract shall be increased by any amount included in gross income by reason of the amount treated as received under the preceding sentence.

(B) Treatment of policyholder dividends. Any amount described in paragraph (1)(B) shall not be included in gross income under paragraph (2)(B)(i) to the extent such amount is retained by the insurer as a premium or other consideration paid for the contract.

(C) Treatment of transfers without adequate consideration.

(i) In general. If an individual who holds an annuity contract transfers it without full and adequate consideration, such individual shall be treated as receiving an amount equal to the excess of—

(I) the cash surrender value of such contract at the time of transfer, over

(II) the investment in such contract at such time,

under the contract as an amount not received as an annuity.

(ii) Exception for certain transfers between spouses or former spouses. Clause (i) shall not apply to any transfer to which section 1041(a) (relating to transfers of property between spouses or incident to divorce) applies.

(iii) Adjustment to investment in contract of transferee. If under clause (i) an amount is included in the gross income of the transferor of an annuity contract, the investment in the contract of the transferee in such contract shall be increased by the amount so included.

**(5) Retention of existing rules in certain cases.**

(A) In general. In any case to which this paragraph applies—

(i) paragraphs (2)(B) and (4)(A) shall not apply, and

(ii) if paragraph (2)(A) does not apply,

the amount shall be included in gross income, but only to the extent it exceeds the investment in the contract.

(B) Existing contracts. This paragraph shall apply to contracts entered into before August 14, 1982. Any amount allocable to investment in the contract after August 13, 1982, shall be treated as from a contract entered into after such date.

(C) Certain life insurance and endowment contracts. Except as provided in paragraph (10) and except to the extent prescribed by the Secretary by regulations, this paragraph shall apply to any amount not received as an annuity which is received under a life insurance or endowment contract.

(D) Contracts under qualified plans. Except as provided in paragraph (8) , this paragraph shall apply to any amount received—

(i) from a trust described in section 401(a) which is exempt from tax under section 501(a) ,

(ii) from a contract—

(I) purchased by a trust described in clause (i) ,

(II) purchased as part of a plan described in section 403(a) ,

(III) described in section 403(b) , or

(IV) provided for employees of a life insurance company under a plan described in section 818(a)(3) , or

(iii) from an individual retirement account or an individual retirement annuity.

Any dividend described in section 404(k) which is received by a participant or beneficiary shall, for purposes of this subparagraph , be treated as paid under a separate contract to which clause (ii)(I) applies.

(E) Full refunds, surrenders, redemptions, and maturities. This paragraph shall apply to—

(i) any amount received, whether in a single sum or otherwise, under a contract in full discharge of the



obligation under the contract which is in the nature of a refund of the consideration paid for the contract, and

(ii) any amount received under a contract on its complete surrender, redemption, or maturity.

In the case of any amount to which the preceding sentence applies, the rule of paragraph (2)(A) shall not apply.

**(6) Investment in the contract.**

For purposes of this subsection , the investment in the contract as of any date is—

(A) the aggregate amount of premiums or other consideration paid for the contract before such date, minus

(B) the aggregate amount received under the contract before such date, to the extent that such amount was excludable from gross income under this subtitle or prior income tax laws.

**(7) Repealed.**

**(8) Extension of paragraph (2)(B) to qualified plans.**

(A) In general. Notwithstanding any other provision of this subsection , in the case of any amount received before the annuity starting date from a trust or contract described in paragraph (5)(D) , paragraph (2)(B) shall apply to such amounts.

(B) Allocation of amount received. For purposes of paragraph (2)(B) , the amount allocated to the investment in the contract shall be the portion of the amount described in subparagraph (A) which bears the same ratio to such amount as the investment in the contract bears to the account balance. The determination under the preceding sentence shall be made as of the time of the distribution or at such other time as the Secretary may prescribe.

(C) Treatment of forfeitable rights. If an employee does not have a nonforfeitable right to any amount under any trust or contract to which subparagraph (A) applies, such amount shall not be treated as part of the account balance.

(D) Investment in the contract before 1987. In the case of a plan which on May 5, 1986, permitted withdrawal of any employee contributions before separation from service, subparagraph (A) shall apply only to the extent that amounts received before the annuity starting date (when increased by amounts previously received under the contract after December 31, 1986) exceed the investment in the contract as of December 31, 1986.

**Caution:** Code Sec. 72(e)(9), following, was amended by P.L. 107-16, EGTRRA. These provisions generally sunset for tax years beginning after 12/31/2012. For

specific sunset provisions, see Sec. 901, P.L. 107-16 (as amended) reproduced in history notes for this Code Sec.

**(9) Extension of paragraph (2)(B) to qualified tuition programs and Coverdell education savings accounts.**

Notwithstanding any other provision of this subsection , paragraph (2)(B) shall apply to amounts received under a qualified tuition program (as defined in section 529(b) ) or under a Coverdell education savings account (as defined in section 530(b) ). The rule of paragraph (8)(B) shall apply for purposes of this paragraph .

**(10) Treatment of modified endowment contracts.**

(A) In general. Notwithstanding paragraph (5)(C) , in the case of any modified endowment contract (as defined in section 7702A )—

(i) paragraphs (2)(B) and (4)(A) shall apply, and

(ii) in applying paragraph (4)(A) , “any person” shall be substituted for “an individual”.

(B) Treatment of certain burial contracts. Notwithstanding subparagraph (A) , paragraph (4)(A) shall not apply to any assignment (or pledge) of a modified endowment contract if such assignment (or pledge) is solely to cover the payment of expenses referred to in section 7702(e)(2)(C)(iii) and if the maximum death benefit under such contract does not exceed \$25,000.

**(11) Special rules for certain combination contracts providing long-term care insurance.**

Notwithstanding paragraphs (2) , (5)(C) , and (10) , in the case of any charge against the cash value of an annuity contract or the cash surrender value of a life insurance contract made as payment for coverage under a qualified long-term care insurance contract which is part of or a rider on such annuity or life insurance contract—

(A) the investment in the contract shall be reduced (but not below zero) by such charge, and

(B) such charge shall not be includible in gross income.

**(12) Anti-abuse rules.**

(A) In general. For purposes of determining the amount includible in gross income under this subsection —

(i) all modified endowment contracts issued by the same company to the same policyholder during any calendar year shall be treated as 1 modified endowment contract, and

(ii) all annuity contracts issued by the same company to the same policyholder during any calendar year shall be treated as 1 annuity contract.

The preceding sentence shall not apply to any contract described in paragraph (5)(D) .

(B) Regulatory authority. The Secretary may by regulations prescribe such additional rules as may be necessary or appropriate to prevent avoidance of the purposes of this subsection through serial purchases of contracts or otherwise.

**(f) Special rules for computing employees' contributions.**

In computing, for purposes of subsection (c)(1)(A) , the aggregate amount of premiums or other consideration paid for the contract, and for purposes of subsection (e)(6) , the aggregate premiums or other consideration paid, amounts contributed by the employer shall be included, but only to the extent that—

(1) such amounts were includible in the gross income of the employee under this subtitle or prior income tax laws; or

(2) if such amounts had been paid directly to the employee at the time they were contributed, they would not have been includible in the gross income of the employee under the law applicable at the time of such contribution.

Paragraph (2) shall not apply to amounts which were contributed by the employer after December 31, 1962, and which would not have been includible in the gross income of the employee by reason of the application of section 911 if such amounts had been paid directly to the employee at the time of contribution. The preceding sentence shall not apply to amounts which were contributed by the employer, as determined under regulations prescribed by the Secretary, to provide pension or annuity credits, to the extent such credits are attributable to services performed before January 1, 1963, and are provided pursuant to pension or annuity plan provisions in existence on March 12, 1962, and on that date applicable to such services, or to the extent such credits are attributable to services performed as a foreign missionary (within the meaning of section 403(b)(2)(D)(iii) , as in effect before the enactment of the Economic Growth and Tax Relief Reconciliation Act of 2001).

**(g) Rules for transferee where transfer was for value.**

Where any contract (or any interest therein) is transferred (by assignment or otherwise) for a valuable consideration, to the extent that the contract (or interest therein) does not, in the hands of the transferee, have a basis which is determined by reference to the basis in the hands of the transferor, then—

(1) for purposes of this section , only the actual value of such consideration, plus the amount of the premiums and other consideration paid by the transferee after the transfer, shall be taken into account in computing the aggregate amount of the premiums or other consideration paid for the contract;

(2) for purposes of subsection (c)(1)(B) , there shall be taken into account only the aggregate amount received under the contract by the transferee before the annuity starting date, to the extent that such amount was excludable from gross income under this subtitle or prior income tax laws; and

**(3)** the annuity starting date is January 1, 1954, or the first day of the first period for which the transferee received an amount under the contract as an annuity, whichever is the later.

For purposes of this subsection , the term "transferee" includes a beneficiary of, or the estate of, the transferee.

**(h) Option to receive annuity in lieu of lump sum.**

If—

**(1)** a contract provides for payment of a lump sum in full discharge of an obligation under the contract, subject to an option to receive an annuity in lieu of such lump sum;

**(2)** the option is exercised within 60 days after the day on which such lump sum first became payable; and

**(3)** part or all of such lump sum would (but for this subsection ) be includible in gross income by reason of subsection (e)(1) ,

then, for purposes of this subtitle, no part of such lump sum shall be considered as includible in gross income at the time such lump sum first became payable.

**(j) Interest.**

Notwithstanding any other provision of this section , if any amount is held under an agreement to pay interest thereon, the interest payments shall be included in gross income.

**(k) Repealed.**

**(l) Face-amount certificates.**

For purposes of this section , the term "endowment contract" includes 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 ), issued after December 31, 1954.

**(m) Special rules applicable to employee annuities and distributions under employee plans.**

**(1) Repealed.**

**(2) Computation of consideration paid by the employee.**

In computing—

(A) the aggregate amount of premiums or other consideration paid for the contract for purposes of subsection (c)(1)(A) (relating to the investment in the contract), and

(B) the aggregate premiums or other consideration paid for purposes of subsection (e)(6) (relating to certain amounts not received as an annuity),

any amount allowed as a deduction with respect to the contract under section 404 which was paid while the employee was an employee within the meaning of section 401(c)(1) shall be treated as consideration contributed by the employer, and there shall not be taken into account any portion of the premiums or other consideration for the contract paid while the employee was an owner-employee which is properly allocable (as determined under regulations prescribed by the Secretary) to the cost of life, accident, health, or other insurance.

**(3) Life insurance contracts.**

(A) This paragraph shall apply to any life insurance contract—

(i) purchased as a part of a plan described in section 403(a) , or

(ii) purchased by a trust described in section 401(a) which is exempt from tax under section 501(a) if the proceeds of such contract are payable directly or indirectly to a participant in such trust or to a beneficiary of such participant.

(B) Any contribution to a plan described in subparagraph (A)(i) or a trust described in subparagraph (A)(ii) which is allowed as a deduction under section 404 , and any income of a trust described in subparagraph (A)(ii) , which is determined in accordance with regulations prescribed by the Secretary to have been applied to purchase the life insurance protection under a contract described in subparagraph (A) , is includible in the gross income of the participant for the taxable year when so applied.

(C) In the case of the death of an individual insured under a contract described in subparagraph (A) , an amount equal to the cash surrender value of the contract immediately before the death of the insured shall be treated as a payment under such plan or a distribution by such trust, and the excess of the amount payable by reason of the death of the insured over such cash surrender value shall not be includible in gross income under this section and shall be treated as provided in section 101 .

**(4) Repealed.**

**(5) Penalties applicable to certain amounts received by 5-percent owners.**

(A) This paragraph applies to amounts which are received from a qualified trust described in section 401(a) or under a plan described in section 403(a) at any time by an individual who is, or has been, a 5-percent owner, or by a successor of such an individual, but only to the extent such amounts are determined, under regulations prescribed by the Secretary, to exceed the benefits provided for such individual under the plan formula.

(B) If a person receives an amount to which this paragraph applies, his tax under this chapter for the taxable year in which such amount is received shall be increased by an amount equal to 10 percent of the portion of the amount so received which is includible in his gross income for such taxable year.

(C) For purposes of this paragraph , the term "5-percent owner" means any individual who, at any time during the 5 plan years preceding the plan year ending in the taxable year in which the amount is received, is a 5-percent owner (as defined in section 416(i)(1)(B) ).

**(6) Owner-employee defined.**

For purposes of this subsection , the term "owner-employee" has the meaning assigned to it by section 401(c)(3) and includes an individual for whose benefit an individual retirement account or annuity described in section 408(a) or (b) is maintained. For purposes of the preceding sentence, the term "owner-employee" shall include an employee within the meaning of section 401(c)(1) .

**(7) Meaning of disabled.**

For purposes of this section , an individual shall be considered to be disabled if he is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or to be of long-continued and indefinite duration. An individual shall not be considered to be disabled unless he furnishes proof of the existence thereof in such form and manner as the Secretary may require.

**(8) Repealed.**

**(9) Repealed.**

**(10) Determination of investment in the contract in the case of qualified domestic relations orders.**

Under regulations prescribed by the Secretary, in the case of a distribution or payment made to an alternate payee who is the spouse or former spouse of the participant pursuant to a qualified domestic relations order (as defined in section 414(p) ), the investment in the contract as of the date prescribed in such regulations shall be allocated on a pro rata basis between the present value of such distribution or payment and the present value of all other benefits payable with respect to the participant to which such order relates.

**(n) Annuities under retired serviceman's family protection plan or survivor benefit plan.**

Subsection (b) shall not apply in the case of amounts received after December 31, 1965, as an annuity under chapter 73 of title 10 of the United States Code , but all such amounts shall be excluded from gross income until there has been so excluded (under section 122(b)(1) or this section , including amounts excluded before January 1, 1966) an amount equal to the consideration for the contract (as defined by section 122(b)(2) ), plus any amount treated pursuant to section 101(b)(2)(D) (as in effect on the day before the date of the enactment of the

Small Business Job Protection Act of 1996) as additional consideration paid by the employee. Thereafter all amounts so received shall be included in gross income.

**(o) Special rules for distributions from qualified plans to which employee made deductible contributions.**

**(1) Treatment of contributions.**

For purposes of this section and sections 402 and 403 , notwithstanding section 414(h) , any deductible employee contribution made to a qualified employer plan or government plan shall be treated as an amount contributed by the employer which is not includible in the gross income of the employee.

**(2) Repealed.**

**(3) Amounts constructively received.**

(A) In general. For purposes of this subsection , rules similar to the rules provided by subsection (p) (other than the exception contained in paragraph (2) thereof ) shall apply.

(B) Purchase of life insurance. To the extent any amount of accumulated deductible employee contributions of an employee are applied to the purchase of life insurance contracts, such amount shall be treated as distributed to the employee in the year so applied.

**(4) Special rule for treatment of rollover amounts.**

For purposes of sections 402(c) , 403(a)(4) , 403(b)(8) , 408(d)(3) , and 457(e)(16) , the Secretary shall prescribe regulations providing for such allocations of amounts attributable to accumulated deductible employee contributions, and for such other rules, as may be necessary to insure that such accumulated deductible employee contributions do not become eligible for additional tax benefits (or freed from limitations) through the use of rollovers.

**(5) Definitions and special rules.**

For purposes of this subsection —

(A) Deductible employee contributions. The term “deductible employee contributions” means any qualified voluntary employee contribution (as defined in section 219(e)(2) ) made after December 31, 1981, in a taxable year beginning after such date and made for a taxable year beginning before January 1, 1987, and allowable as a deduction under section 219(a) for such taxable year.

(B) Accumulated deductible employee contributions. The term “accumulated deductible employee contributions” means the deductible employee contributions—

(i) increased by the amount of income and gain allocable to such contributions, and

(ii) reduced by the sum of the amount of loss and expense allocable to such contributions and the amounts distributed with respect to the employee which are attributable to such contributions (or income or gain allocable to such contributions).

(C) Qualified employer plan. The term "qualified employer plan" has the meaning given to such term by subsection (p)(3)(A)(i) .

(D) Government plan. The term "government plan" has the meaning given such term by subsection (p)(3)(B) .

**(6) Ordering rules.**

Unless the plan specifies otherwise, any distribution from such plan shall not be treated as being made from the accumulated deductible employee contributions until all other amounts to the credit of the employee have been distributed.

**(p) Loans treated as distributions.**

For purposes of this section —

**(1) Treatment as distributions.**

(A) Loans. If during any taxable year a participant or beneficiary receives (directly or indirectly) any amount as a loan from a qualified employer plan, such amount shall be treated as having been received by such individual as a distribution under such plan.

(B) Assignments or pledges. If during any taxable year a participant or beneficiary assigns (or agrees to assign) or pledges (or agrees to pledge) any portion of his interest in a qualified employer plan, such portion shall be treated as having been received by such individual as a loan from such plan.

**(2) Exception for certain loans.**

(A) General rule. Paragraph (1) shall not apply to any loan to the extent that such loan (when added to the outstanding balance of all other loans from such plan whether made on, before, or after August 13, 1982), does not exceed the lesser of—

(i) \$50,000, reduced by the excess (if any) of—

(I) the highest outstanding balance of loans from the plan during the 1-year period ending on the day before the date on which such loan was made, over

(II) the outstanding balance of loans from the plan on the date on which such loan was made, or

(ii) the greater of (I) one-half of the present value of the nonforfeitable accrued benefit of the employee under the plan, or (II) \$10,000.



For purposes of clause (ii) , the present value of the nonforfeitable accrued benefit shall be determined without regard to any accumulated deductible employee contributions (as defined in subsection (o)(5)(B) ).

(B) Requirement that loan be repayable within 5 years.

(i) In general. Subparagraph (A) shall not apply to any loan unless such loan, by its terms, is required to be repaid within 5 years.

(ii) Exception for home loans. Clause (i) shall not apply to any loan used to acquire any dwelling unit which within a reasonable time is to be used (determined at the time the loan is made) as the principal residence of the participant.

(C) Requirement of level amortization. Except as provided in regulations, this paragraph shall not apply to any loan unless substantially level amortization of such loan (with payments not less frequently than quarterly) is required over the term of the loan.

(D) Related employers and related plans. For purposes of this paragraph —

(i) the rules of subsections (b) , (c) , and (m) of section 414 shall apply, and

(ii) all plans of an employer (determined after the application of such subsections) shall be treated as 1 plan.

### **(3) Denial of interest deductions in certain cases.**

(A) In general. No deduction otherwise allowable under this chapter shall be allowed under this chapter for any interest paid or accrued on any loan to which paragraph (1) does not apply by reason of paragraph (2) during the period described in subparagraph (B) .

(B) Period to which subparagraph (A) applies. For purposes of subparagraph (A) , the period described in this subparagraph is the period—

(i) on or after the 1st day on which the individual to whom the loan is made is a key employee (as defined in section 416(i) ), or

(ii) such loan is secured by amounts attributable to elective deferrals described in subparagraph (A) or (C) of section 402(g)(3) .

### **(4) Qualified employer plan, etc.**

For purposes of this subsection —

(A) Qualified employer plan.—

(i) In general. The term “qualified employer plan” means—

(I) a plan described in section 401(a) which includes a trust exempt from tax under section 501(a) ,

(II) an annuity plan described in section 403(a) ,  
and

(III) a plan under which amounts are contributed by an individual's employer for an annuity contract described in section 403(b) .

(ii) Special rule. The term “qualified employer plan” shall include any plan which was (or was determined to be) a qualified employer plan or a government plan.

(B) Government plan. The term “government plan” means any plan, whether or not qualified, established and maintained for its employees by the United States, by a State or political subdivision thereof, or by an agency or instrumentality of any of the foregoing.

**(5) Special rules for loans, etc., from certain contracts.**

For purposes of this subsection , any amount received as a loan under a contract purchased under a qualified employer plan (and any assignment or pledge with respect to such a contract) shall be treated as a loan under such employer plan.

**(q) 10-percent penalty for premature distributions from annuity contracts**

**(1) Imposition of penalty.**

If any taxpayer receives any amount under an annuity contract, the taxpayer's tax under this chapter for the taxable year in which such amount is received shall be increased by an amount equal to 10 percent of the portion of such amount which is includible in gross income.

**(2) Subsection not to apply to certain distributions.**

Paragraph (1) shall not apply to any distribution—

(A) made on or after the date on which the taxpayer attains age 59½,

(B) made on or after the death of the holder (or, where the holder is not an individual, the death of the primary annuitant (as defined in subsection (s)(6)(B) )),

(C) attributable to the taxpayer's becoming disabled within the meaning of subsection (m)(7) ,

(D) which is a part of a series of substantially equal periodic payments (not less frequently than annually) made for the life (or

life expectancy) of the taxpayer or the joint lives (or joint life expectancies) of such taxpayer and his designated beneficiary,

(E) from a plan, contract, account, trust, or annuity described in subsection (e)(5)(D) ,

(F) allocable to investment in the contract before August 14, 1982,

(G) under a qualified funding asset (within the meaning of section 130(d) , but without regard to whether there is a qualified assignment),

(H) to which subsection (t) applies (without regard to paragraph (2) thereof ),

(I) under an immediate annuity contract (within the meaning of section 72(u)(4) ), or

(J) which is purchased by an employer upon the termination of a plan described in section 401(a) or 403(a) and which is held by the employer until such time as the employee separates from service.

**(3) Change in substantially equal payments.**

If—

(A) paragraph (1) does not apply to a distribution by reason of paragraph (2)(D) , and

(B) the series of payments under such paragraph are subsequently modified (other than by reason of death or disability)—

(i) before the close of the 5-year period beginning on the date of the first payment and after the taxpayer attains age 59½, or

(ii) before the taxpayer attains age 59½,

the taxpayer's tax for the 1st taxable year in which such modification occurs shall be increased by an amount, determined under regulations, equal to the tax which (but for paragraph (2)(D) ) would have been imposed, plus interest for the deferral period (within the meaning of subsection (t)(4)(B) ).

**(r) Certain railroad retirement benefits treated as received under employer plans.**

**(1) In general.**

Notwithstanding any other provision of law, any benefit provided under the Railroad Retirement Act of 1974 (other than a tier 1 railroad retirement benefit) shall be treated for purposes of this title as a benefit provided under an employer plan which meets the requirements of section 401(a) .

**(2) Tier 2 taxes treated as contributions.**

(A) In general. For purposes of paragraph (1) —

(i) the tier 2 portion of the tax imposed by section 3201 (relating to tax on employees) shall be treated as an employee contribution,

(ii) the tier 2 portion of the tax imposed by section 3211 (relating to tax on employee representatives) shall be treated as an employee contribution, and

(iii) the tier 2 portion of the tax imposed by section 3221 (relating to tax on employers) shall be treated as an employer contribution.

(B) Tier 2 portion. For purposes of subparagraph (A) —

(i) After 1984. With respect to compensation paid after 1984, the tier 2 portion shall be the taxes imposed by sections 3201(b) , 3211(b) , and 3221(b) .

(ii) After September 30, 1981, and before 1985. With respect to compensation paid before 1985 for services rendered after September 30, 1981, the tier 2 portion shall be —

(I) so much of the tax imposed by section 3201 as is determined at the 2 percent rate, and

(II) so much of the taxes imposed by sections 3211 and 3221 as is determined at the 11.75 percent rate.

With respect to compensation paid for services rendered after December 31, 1983, and before 1985, subclause (I) shall be applied by substituting "2.75 percent" for "2 percent", and subclause (II) shall be applied by substituting "12.75 percent" for "11.75 percent".

(iii) Before October 1, 1981. With respect to compensation paid for services rendered during any period before October 1, 1981, the tier 2 portion shall be the excess (if any) of—

(I) the tax imposed for such period by section 3201 , 3211 , or 3221 , as the case may be (other than any tax imposed with respect to man-hours), over

(II) the tax which would have been imposed by such section for such period had the rates of the comparable taxes imposed by chapter 21 for such period applied under such section.

(C) Contributions not allocable to supplemental annuity or windfall benefits. For purposes of paragraph (1) , no amount treated as an employee contribution under this paragraph shall be allocated to—

(i) any supplemental annuity paid under section 2(b) of the Railroad Retirement Act of 1974, or

(ii) any benefit paid under section 3(h), 4(e), or 4(h) of such Act.

**(3) Tier 1 railroad retirement benefit.**

For purposes of paragraph (1) , the term "tier 1 railroad retirement benefit" has the meaning given such term by section 86(d)(4) .

**(s) Required distributions where holder dies before entire interest is distributed.**

**(1) In general.**

A contract shall not be treated as an annuity contract for purposes of this title unless it provides that—

(A) if any holder of such contract dies on or after the annuity starting date and before the entire interest in such contract has been distributed, the remaining portion of such interest will be distributed at least as rapidly as under the method of distributions being used as of the date of his death, and

(B) if any holder of such contract dies before the annuity starting date, the entire interest in such contract will be distributed within 5 years after the death of such holder.

**(2) Exception for certain amounts payable over life of beneficiary.**

If—

(A) any portion of the holder's interest is payable to (or for the benefit of) a designated beneficiary,

(B) such portion will be distributed (in accordance with regulations) over the life of such designated beneficiary (or over a period not extending beyond the life expectancy of such beneficiary), and

(C) such distributions begin not later than 1 year after the date of the holder's death or such later date as the Secretary may by regulations prescribe,

then for purposes of paragraph (1) , the portion referred to in subparagraph (A) shall be treated as distributed on the day on which such distributions begin.

**(3) Special rule where surviving spouse beneficiary.**

If the designated beneficiary referred to in paragraph (2)(A) is the

surviving spouse of the holder of the contract, paragraphs (1) and (2) shall be applied by treating such spouse as the holder of such contract.

**(4) Designated beneficiary.**

For purposes of this subsection , the term "designated beneficiary" means any individual designated a beneficiary by the holder of the contract.

**(5) Exception for certain annuity contracts.**

This subsection shall not apply to any annuity contract—

(A) which is provided—

(i) under a plan described in section 401(a) which includes a trust exempt from tax under section 501 , or

(ii) under a plan described in section 403(a) ,

(B) which is described in section 403(b) ,

(C) which is an individual retirement annuity or provided under an individual retirement account or annuity, or,

(D) which is a qualified funding asset (as defined in section 130(d) , but without regard to whether there is a qualified assignment).

**(6) Special rule where holder is corporation or other non-individual.**

(A) In general. For purposes of this subsection , if the holder of the contract is not an individual, the primary annuitant shall be treated as the holder of the contract.

(B) Primary annuitant. For purposes of subparagraph (A) , the term "primary annuitant" means the individual, the events in the life of whom are of primary importance in affecting the timing or amount of the payout under the contract.

**(7) Treatment of changes in primary annuitant where holder of contract is not an individual.**

For purposes of this subsection , in the case of a holder of an annuity contract which is not an individual, if there is a change in a primary annuitant (as defined in paragraph (6)(B) ), such change shall be treated as the death of the holder.

**(t) 10-percent additional tax on early distributions from qualified retirement plans.**

**(1) Imposition of additional tax.**

If any taxpayer receives any amount from a qualified retirement plan (as defined in section 4974(c) ), the taxpayer's tax under this chapter for the taxable year in which such amount is received shall be increased by an amount equal to 10 percent of the portion of such amount which is includible in gross income.

**(2) Subsection not to apply to certain distributions.**

Except as provided in paragraphs (3) and (4) , paragraph (1) shall not apply to any of the following distributions:

(A) In general. Distributions which are—

(i) made on or after the date on which the employee attains age 59½,

(ii) made to a beneficiary (or to the estate of the employee) on or after the death of the employee,

(iii) attributable to the employee's being disabled within the meaning of subsection (m)(7) ,

(iv) part of a series of substantially equal periodic payments (not less frequently than annually) made for the life (or life expectancy) of the employee or the joint lives (or joint life expectancies) of such employee and his designated beneficiary,

(v) made to an employee after separation from service after attainment of age 55,

(vi) dividends paid with respect to stock of a corporation which are described in section 404(k) , or

(vii) made on account of a levy under section 6331 on the qualified retirement plan.

(B) Medical expenses. Distributions made to the employee (other than distributions described in subparagraph (A) , (C) , or (D) ) to the extent such distributions do not exceed the amount allowable as a deduction under section 213 to the employee for amounts paid during the taxable year for medical care (determined without regard to whether the employee itemizes deductions for such taxable year).

(C) Payments to alternate payees pursuant to qualified domestic relations orders. Any distribution to an alternate payee pursuant to a qualified domestic relations order (within the meaning of section 414(p)(1) ).

(D) Distributions to unemployed individuals for health insurance premiums.

(i) In general. Distributions from an individual retirement plan to an individual after separation from employment—

(I) if such individual has received unemployment compensation for 12 consecutive weeks under any Federal or State unemployment compensation law by reason of such separation,

(II) if such distributions are made during any taxable year during which such unemployment compensation is paid or the succeeding taxable year, and

(III) to the extent such distributions do not exceed the amount paid during the taxable year for insurance described in section 213(d)(1)(D) with respect to the individual and the individual's spouse and dependents (as defined in section 152 , determined without regard to subsections (b)(1) , (b)(2) , and (d)(1)(B) thereof).

(ii) Distributions after reemployment. Clause (i) shall not apply to any distribution made after the individual has been employed for at least 60 days after the separation from employment to which clause (i) applies.

(iii) Self-employed individuals. To the extent provided in regulations, a self-employed individual shall be treated as meeting the requirements of clause (i)(I) if, under Federal or State law, the individual would have received unemployment compensation but for the fact the individual was self-employed.

(E) Distributions from individual retirement plans for higher education expenses. Distributions to an individual from an individual retirement plan to the extent such distributions do not exceed the qualified higher education expenses (as defined in paragraph (7) ) of the taxpayer for the taxable year. Distributions shall not be taken into account under the preceding sentence if such distributions are described in subparagraph (A) , (C) , or (D) or to the extent paragraph (1) does not apply to such distributions by reason of subparagraph (B) .

(F) Distributions from certain plans for first home purchases. Distributions to an individual from an individual retirement plan which are qualified first-time homebuyer distributions (as defined in paragraph (8) ). Distributions shall not be taken into account under the preceding sentence if such distributions are described in subparagraph (A) , (C) , (D) , or (E) or to the extent paragraph (1) does not apply to such distributions by reason of subparagraph (B) .

(G) Distributions from retirement plans to individuals called to active duty.

(i) In general. Any qualified reservist distribution.

(ii) Amount distributed may be repaid. Any individual who receives a qualified reservist distribution may, at any time during the 2-year period beginning on the day after the end of the active duty period, make one or more contributions to an individual retirement plan of such individual in an



aggregate amount not to exceed the amount of such distribution. The dollar limitations otherwise applicable to contributions to individual retirement plans shall not apply to any contribution made pursuant to the preceding sentence. No deduction shall be allowed for any contribution pursuant to this clause.

(iii) Qualified reservist distribution. For purposes of this subparagraph, the term "qualified reservist distribution" means any distribution to an individual if—

(I) such distribution is from an individual retirement plan, or from amounts attributable to employer contributions made pursuant to elective deferrals described in subparagraph (A) or (C) of section 402(g)(3) or section 501(c)(18)(D)(iii) ,

(II) such individual was (by reason of being a member of a reserve component (as defined in section 101 of title 37, United States Code)) ordered or called to active duty for a period in excess of 179 days or for an indefinite period, and

(III) such distribution is made during the period beginning on the date of such order or call and ending at the close of the active duty period.

(iv) Application of subparagraph. This subparagraph applies to individuals ordered or called to active duty after September 11, 2001. In no event shall the 2-year period referred to in clause (ii) end on or before the date which is 2 years after the date of the enactment of this subparagraph.

### **(3) Limitations.**

(A) Certain exceptions not to apply to individual retirement plans. Subparagraphs (A)(v) and (C) of paragraph (2) shall not apply to distributions from an individual retirement plan.

(B) Periodic payments under qualified plans must begin after separation. Paragraph (2)(A)(iv) shall not apply to any amount paid from a trust described in section 401(a) which is exempt from tax under section 501(a) or from a contract described in section 72(e)(5)(D)(ii) unless the series of payments begins after the employee separates from service.

### **(4) Change in substantially equal payments.**

(A) In general. If—

(i) paragraph (1) does not apply to a distribution by reason of paragraph (2)(A)(iv) , and

(ii) the series of payments under such paragraph are subsequently modified (other than by reason of death or disability)—

(I) before the close of the 5-year period beginning with the date of the first payment and after the employee attains age 59½, or

(II) before the employee attains age 59½,

the taxpayer's tax for the 1st taxable year in which such modification occurs shall be increased by an amount, determined under regulations, equal to the tax which (but for paragraph (2)(A)(iv) ) would have been imposed, plus interest for the deferral period.

(B) Deferral period. For purposes of this paragraph , the term "deferral period" means the period beginning with the taxable year in which (without regard to paragraph (2)(A)(iv) ) the distribution would have been includible in gross income and ending with the taxable year in which the modification described in subparagraph (A) occurs.

**(5) Employee.**

For purposes of this subsection , the term "employee" includes any participant, and in the case of an individual retirement plan, the individual for whose benefit such plan was established.

**(6) Special rules for simple retirement accounts.**

In the case of any amount received from a simple retirement account (within the meaning of section 408(p) ) during the 2-year period beginning on the date such individual first participated in any qualified salary reduction arrangement maintained by the individual's employer under section 408(p)(2) , paragraph (1) shall be applied by substituting "25 percent" for "10 percent".

**(7) Qualified higher education expenses.**

For purposes of paragraph (2)(E) —

(A) In general. The term "qualified higher education expenses" means qualified higher education expenses (as defined in section 529(e)(3) ) for education furnished to—

(i) the taxpayer,

(ii) the taxpayer's spouse, or

(iii) any child (as defined in section 152(f)(1) ) or grandchild of the taxpayer or the taxpayer's spouse,

at an eligible educational institution (as defined in section 529(e)(5) ).

(B) Coordination with other benefits. The amount of qualified higher education expenses for any taxable year shall be reduced as provided in section 25A(g)(2) .

**(8) Qualified first-time homebuyer distributions.**

For purposes of paragraph (2)(F) —

(A) In general. The term “qualified first-time homebuyer distribution” means any payment or distribution received by an individual to the extent such payment or distribution is used by the individual before the close of the 120th day after the day on which such payment or distribution is received to pay qualified acquisition costs with respect to a principal residence of a first-time homebuyer who is such individual, the spouse of such individual, or any child, grandchild, or ancestor of such individual or the individual's spouse.

(B) Lifetime dollar limitation. The aggregate amount of payments or distributions received by an individual which may be treated as qualified first-time homebuyer distributions for any taxable year shall not exceed the excess (if any) of—

(i) \$10,000, over

(ii) the aggregate amounts treated as qualified first-time homebuyer distributions with respect to such individual for all prior taxable years.

(C) Qualified acquisition costs. For purposes of this paragraph , the term “qualified acquisition costs” means the costs of acquiring, constructing, or reconstructing a residence. Such term includes any usual or reasonable settlement, financing, or other closing costs.

(D) First-time homebuyer; other definitions. For purposes of this paragraph —

(i) First-time homebuyer. The term “first-time homebuyer” means any individual if—

(I) such individual (and if married, such individual's spouse) had no present ownership interest in a principal residence during the 2-year period ending on the date of acquisition of the principal residence to which this paragraph applies, and

(II) subsection (h) or (k) of section 1034 (as in effect on the day before the date of the enactment of this paragraph ) did not suspend the running of any period of time specified in section 1034 (as so in effect) with respect to such individual on the day before the date the distribution is applied pursuant to subparagraph (A) .

(ii) Principal residence. The term "principal residence" has the same meaning as when used in section 121 .

(iii) Date of acquisition. The term "date of acquisition" means the date—

(I) on which a binding contract to acquire the principal residence to which subparagraph (A) applies is entered into, or

(II) on which construction or reconstruction of such a principal residence is commenced.

(E) Special rule where delay in acquisition. If any distribution from any individual retirement plan fails to meet the requirements of subparagraph (A) solely by reason of a delay or cancellation of the purchase or construction of the residence, the amount of the distribution may be contributed to an individual retirement plan as provided in section 408(d)(3)(A)(i) (determined by substituting "120th day" for "60th day" in such section), except that—

(i) section 408(d)(3)(B) shall not be applied to such contribution, and

(ii) such amount shall not be taken into account in determining whether section 408(d)(3)(B) applies to any other amount.

**(9) Special rule for rollovers to section 457 plans.**

For purposes of this subsection , a distribution from an eligible deferred compensation plan (as defined in section 457(b) ) of an eligible employer described in section 457(e)(1)(A) shall be treated as a distribution from a qualified retirement plan described in 4974(c)(1) to the extent that such distribution is attributable to an amount transferred to an eligible deferred compensation plan from a qualified retirement plan (as defined in section 4974(c) ).

**(10) Distributions to qualified public safety employees in governmental plans.**

(A) In general. In the case of a distribution to a qualified public safety employee from a governmental plan (within the meaning of section 414(d)) which is a defined benefit plan, paragraph (2)(A)(v) shall be applied by substituting "age 50" for "age 55".

(B) Qualified public safety employee. For purposes of this paragraph, the term "qualified public safety employee" means any employee of a State or political subdivision of a State who provides police protection, firefighting services, or emergency medical services for any area within the jurisdiction of such State or political subdivision.

**(u) Treatment of annuity contracts not held by natural persons.**

**(1) In general.**

If any annuity contract is held by a person who is not a natural person—

(A) such contract shall not be treated as an annuity contract for purposes of this subtitle (other than subchapter L), and

(B) the income on the contract for any taxable year of the policyholder shall be treated as ordinary income received or accrued by the owner during such taxable year.

For purposes of this paragraph , holding by a trust or other entity as an agent for a natural person shall not be taken into account.

**(2) Income on the contract.**

(A) In general. For purposes of paragraph (1) , the term “income on the contract” means, with respect to any taxable year of the policyholder, the excess of—

(i) the sum of the net surrender value of the contract as of the close of the taxable year plus all distributions under the contract received during the taxable year or any prior taxable year, reduced by

(ii) the sum of the amount of net premiums under the contract for the taxable year and prior taxable years and amounts includible in gross income for prior taxable years with respect to such contract under this subsection .

Where necessary to prevent the avoidance of this subsection , the Secretary may substitute “fair market value of the contract” for “net surrender value of the contract” each place it appears in the preceding sentence.

(B) Net premiums. For purposes of this paragraph , the term “net premiums” means the amount of premiums paid under the contract reduced by any policyholder dividends.

**(3) Exceptions.**

This subsection shall not apply to any annuity contract which—

(A) is acquired by the estate of a decedent by reason of the death of the decedent,

(B) is held under a plan described in section 401(a) or 403(a) , under a program described in section 403(b) , or under an individual retirement plan,

(C) is a qualified funding asset (as defined in section 130(d) , but without regard to whether there is a qualified assignment),

(D) is purchased by an employer upon the termination of a plan described in section 401(a) or 403(a) and is held by the employer until all amounts under such contract are distributed to the employee for whom such contract was purchased or the employee's beneficiary, or

(E) is an immediate annuity.

**(4) Immediate annuity.**

For purposes of this subsection , the term "immediate annuity" means an annuity—

(A) which is purchased with a single premium or annuity consideration,

(B) the annuity starting date (as defined in subsection (c)(4) ) of which commences no later than 1 year from the date of the purchase of the annuity, and

(C) which provides for a series of substantially equal periodic payments (to be made not less frequently than annually) during the annuity period.

**(v) 10-percent additional tax for taxable distributions from modified endowment contracts.**

**(1) Imposition of additional tax.**

If any taxpayer receives any amount under a modified endowment contract (as defined in section 7702A ), the taxpayer's tax under this chapter for the taxable year in which such amount is received shall be increased by an amount equal to 10 percent of the portion of such amount which is includible in gross income.

**(2) Subsection not to apply to certain distributions.**

Paragraph (1) shall not apply to any distribution—

(A) made on or after the date on which the taxpayer attains age 59½,

(B) which is attributable to the taxpayer's becoming disabled (within the meaning of subsection (m)(7) ), or

(C) which is part of a series of substantially equal periodic payments (not less frequently than annually) made for the life (or life expectancy) of the taxpayer or the joint lives (or joint life expectancies) of such taxpayer and his beneficiary.

**(w) Application of basis rules to nonresident aliens.**

**(1) In general.**

Notwithstanding any other provision of this section , for purposes of determining the portion of any distribution which is includible in gross income of a distributee who is a citizen or resident of the United States,

the investment in the contract shall not include any applicable nontaxable contributions or applicable nontaxable earnings.

**(2) Applicable nontaxable contribution.**

For purposes of this subsection , the term "applicable nontaxable contribution" means any employer or employee contribution—

(A) which was made with respect to compensation—

(i) for labor or personal services performed by an employee who, at the time the labor or services were performed, was a nonresident alien for purposes of the laws of the United States in effect at such time, and

(ii) which is treated as from sources without the United States, and

(B) which was not subject to income tax (and would have been subject to income tax if paid as cash compensation when the services were rendered) under the laws of the United States or any foreign country.

**(3) Applicable nontaxable earnings.**

For purposes of this subsection , the term "applicable nontaxable earnings" means earnings—

(A) which are paid or accrued with respect to any employer or employee contribution which was made with respect to compensation for labor or personal services performed by an employee,

(B) with respect to which the employee was at the time the earnings were paid or accrued a nonresident alien for purposes of the laws of the United States, and

(C) which were not subject to income tax under the laws of the United States or any foreign country.

**(4) Regulations.**

The Secretary shall prescribe such regulations as may be necessary to carry out the provisions of this subsection , including regulations treating contributions and earnings as not subject to tax under the laws of any foreign country where appropriate to carry out the purposes of this subsection .

**(x) Cross reference.**

For limitation on adjustments to basis of annuity contracts sold, see section 1021 .