Important Changes for 1997

Required beginning date for distributions. Beginning in 1997, required minimum distributions of your interest in a tax-sheltered annuity contract generally do not have to be made until April 1 of the calendar year following the later of the calendar year in which you become age 70 1/2 or the calendar year in which you retire. See Minimum Distributions, later.

Certain ministers treated as employed by tax-exempt organization. Beginning in 1997, a duly ordained or licensed minister of a church who is working as a minister or chaplain, but is self-employed or is working for an employer that is not a qualified tax-exempt organization, is treated as employed by a qualified tax-exempt organization for purposes of participating in a church plan (tax-sheltered annuity plan). See Employees of Certain Tax-Exempt Organizations, later.

Contributions by self-employed ministers and chaplains. Beginning in 1997, contributions made by a self-employed minister or chaplain who is treated as employed by a qualified tax-exempt organization to a retirement income account that is treated as a tax-sheltered annuity are deductible up to the limits for elective contributions to tax-sheltered annuities. For this purpose, all plans in which the minister participates are treated as one plan. See Exclusion Limits, later.

Includible compensation — self-employed minister. Beginning in 1997, compensation of a self-employed minister who is treated as
employed by a tax-exempt organization is the minister's net earnings from self-employment reduced by contributions to retirement plans and the deduction for one-half of the self-employment tax. See Includible Compensation, later.

Years of service — self-employed minister. Beginning in 1997, years of service for purposes of section 403(b) includes full years (and fractional years) in which a self-employed minister is treated as employed by a qualified tax-exempt organization. See Years of Service, later.

Important Changes for 1998

Includible Compensation. Beginning in 1998, for purposes of figuring your exclusion allowance, which is the amount of employer contributions (including elective deferrals) to your tax-sheltered annuity that you can exclude from income, your includible compensation includes:

1) Elective deferrals (your employer's contributions made on your behalf under a salary reduction agreement),
2) Amounts contributed or deferred by your employer under a Section 125 cafeteria plan, and
3) Amounts contributed or deferred under a Section 457 plan (state or local government or tax-exempt organization plan).

For more information on includible compensation, see Includible Compensation, later.

Contributions — Employed Ministers. Beginning in 1998, contributions made to a church plan on behalf of a minister employed by an employer other than the church are excluded from the minister's gross income if they would have been excluded had the minister been an employee of the church. For purposes of this rule, a minister of a church also includes:

1) A self-employed minister, and
2) A minister employed by an organization other than a tax-exempt organization that shares a common religious bond with the minister.

For more information on exclusion of contributions to church plans, see Special Rules, under Includible Compensation, later.

Introduction

This publication explains the Federal tax provisions that apply to tax-sheltered annuity (TSA) plans offered to employees of public schools and certain tax-exempt organizations. The discussions primarily cover employer contributions (elective deferrals) made under a salary reduction agreement. The publication is for employees who participate in tax-sheltered annuity plans. It is not for custodians or plan administrators because it does not cover many of the operating requirements of these plans.

A tax-sheltered annuity plan, often referred to as a "403(b) plan," "tax-deferred annuity plan," or simply "TSA plan" (which is used in this publication), is a retirement plan that, if operated properly by a qualified employer, is tax-exempt.

A qualified employer can purchase tax-sheltered annuities for eligible employees. Three types of employers qualify — public schools, certain tax-exempt organizations, and certain employers of ministers. Your employer may be able to help you determine whether you are an eligible employee.

The most common way to contribute to tax-sheltered annuity plans is through a salary reduction agreement. A salary reduction agreement is an agreement under which an employee agrees to take a reduction in salary or to forego a salary increase and the employer contributes that amount to a tax-sheltered annuity (TSA) plan for that employee. These employer contributions are called "elective deferrals." A TSA plan can also be funded through non-elective employer contributions, employee contributions, or a combination of these.

There is an annual limit on elective deferrals. Generally, you cannot defer more than $9,500 for 1997 for all plans covering you, including TSAs. If elective deferral contributions on your behalf are more than the allowable amount, you must include the excess in your gross income.

Limits are placed on the contributions that can be made by an employer to tax-sheltered annuity (TSA) programs. Special rules may apply in determining the limit on employer contributions for you to a tax-sheltered annuity (TSA) plan if you also are covered by a qualified plan.

The exclusion allowance is the amount of employer contributions (including elective deferrals) to your tax-sheltered annuity (TSA) that you can exclude from income. You pay tax on these excluded amounts when you receive a distribution from the TSA.

Employees of educational organizations, hospitals, home health service agencies, health and welfare service agencies, churches, and certain church-related organizations can elect to substitute the limit on employer contributions for the exclusion allowance under an alternate rule called the Overall Limit.

The Other Rules section includes discussions on the taxability of the cost of insurance under a TSA and on employer contributions subject to social security and Medicare taxes.

In most cases, the payments you receive, or that are made available to you under your TSA contract are taxable in full as ordinary income. In general, the same tax rules apply to distributions from tax-sheltered annuities that apply to distributions from other retirement plans. These rules are explained in Publication 575, Pension and Annuity Income. If you transfer all or part of your interest from a tax-sheltered annuity contract or account to another tax-sheltered annuity contract or account, the transfer may be tax free. You can generally roll over tax free all or any part of a distribution from a tax-sheltered annuity (TSA) plan to an IRA or another TSA plan.

You can use the worksheets at the end of this publication to figure many of the limits that apply to your tax-sheltered annuity (TSA).

Useful Items

You may want to see:

Publication

☐ 575 Pension and Annuity Income

☐ 590 Individual Retirement Arrangements (IRAs)

Form (and Instructions)

☐ W–2 Wage and Tax Statement

☐ 1099-R Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.

☐ 5330 Return of Excise Taxes Related to Employee Benefit Plans

See How To Get More Information, near the end of this publication for information about getting these publications and forms.

What Is a Tax-Sheltered Annuity (TSA) Plan?

A tax-sheltered annuity plan, often referred to as a “403(b) plan,” “tax-deferred annuity plan,” or simply “TSA plan” (which is used in this publication), is a retirement plan that, if operated properly by a qualified employer, is tax-exempt. The TSA plan can invest funds for participating employees in:

• Annuity contracts,

• Custodial accounts holding mutual fund shares, or

• Retirement income accounts (defined contribution plans maintained by churches or certain church-related organizations).

Throughout this publication, wherever “TSA” appears, it refers to any of these funding arrangements, unless otherwise specified.

Tax advantage for employees. Generally, contributions by a qualified employer to purchase an annuity contract for you under a TSA plan (and earnings on them) are excluded from your taxable income until you begin to receive annuity payments, usually after retiring, from your TSA. Because of this tax postponement, these plans are described as "tax-deferred" or "tax-sheltered" annuities.

Qualified Employer

A qualified employer can purchase TSAs for eligible employees. Three types of employers qualify — public schools, certain tax-exempt organizations, and certain employers of ministers.
Public Schools
A state or local government or any of its agencies or instrumentalities can be a qualified employer. For this purpose, an Indian tribal government is a state government. Also, see Indian tribal governments, under Tax-Exempt Organizations, later. These employers are qualified employers only for employees who perform (or have performed) services, directly or indirectly, for an educational organization.

Educational organization. An educational organization is one that normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of students in attendance at the place where it regularly carries on educational activities.

Tax-Exempt Organizations
Generally, a qualified employer includes an organization that is tax exempt because it is organized and operated exclusively for religious, charitable, scientific, public safety testing, literary, or educational purposes. A qualified employer also includes a tax-exempt organization that is organized and operated exclusively to encourage national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals. The organization can be a corporation, community chest, fund, or foundation.

Indian tribal governments. Any TSA contract that was purchased by an Indian tribal government for its employees in a plan year beginning before January 1, 1995, is treated as having been purchased by a tax-exempt organization that is qualified to provide TSAs for its employees. An Indian tribal government includes any political subdivisions, agencies, and instrumentalities of it, as well as any corporations that are chartered under federal, state, or tribal law and owned by it.

Government instrumentalities. Wholly-owned instrumentalities (other than public schools, described earlier) of state or municipal governments generally are not qualified employers. However, if an instrumentality has been separately organized and has been recognized as tax-exempt by the Internal Revenue Service because it is organized and operated exclusively for one or more of the exempt purposes described earlier, it is a qualified employer. A separately organized school, college, university, or hospital may qualify, if it is not an activity essential to and conducted under a branch or department of a state or municipal government.

A cooperative hospital service organization that meets certain requirements is a qualified employer.

Uniformed Services University of the Health Sciences. This is a federal organization authorized to train medical students for the uniformed services. The rules in this publication apply to annuities bought for civilian faculty and staff for work they performed after 1979.

Certain Employers of Ministers
A duly ordained or licensed minister of a church, who in connection with the exercise of his or her ministry is either:

1) Self-employed or
2) Employed by an organization other than a tax-exempt organization (a chaplain), is treated as employed by a tax-exempt organization.

Eligible Employees
A qualified employer can purchase TSAs only for eligible employees. If you are subject to the will and control of an employer regarding what work you do and how you do it, you are an employee. If you are subject to the control or direction of another as to the result only, and not how you do the work, you will generally be an independent contractor, and not an eligible employee. Your employer may be able to help you determine whether you are an eligible employee.

Employees of Public School Systems
You are considered eligible if you perform services as an employee, either directly or indirectly, for a public school. For example, the principal, clerical employees, custodial employees, and teachers at a public elementary school are employees performing services directly for an educational organization. If you do not work in a school, but are involved in the operation or direction of the educational program carried out in public schools, you are an eligible employee performing services indirectly for public schools. Also, you are an eligible employee if you are participating in an in-home teaching program since the program is merely an extension of the activities carried on by public schools.

Department of Education employees appointed by a state commissioner of education. Janitorial, custodial, and general clerical employees indirectly perform services for an educational organization and are eligible employees. If you have a significant degree of executive or policymaking authority, and your appointment is based on required training or experience in the field of education, you also indirectly perform service for an educational organization and are eligible employees.

Elected or appointed to office. If you occupy an elective or appointive office, you may be an eligible employee. You are an eligible employee if your office is one to which a person is elected or appointed only if he or she has received training, or is experienced, in the field of education.

A commissioner or superintendent of education generally is considered an employee performing services for an educational organization. However, a university regent or trustee, or a member of a board of education, is not an eligible employee.

Employees of a state teachers' retirement system. Employees of a retirement system that administers a state teachers' retirement program are not eligible to participate in a TSA program because these employees are not performing services directly or indirectly for an educational organization.

Employees of Certain Tax-Exempt Organizations
Certain tax-exempt organizations (described under Qualified Employer, earlier) can purchase TSAs for some or all of their employees. Employees of these tax-exempt organizations include individuals who perform services as social workers, members of the clergy, teachers, professors, clerks, secretaries, etc.

A physician who works in a hospital as an employee may be eligible. Eligibility depends upon the amount of supervision and control of the services performed and other factors.

A physician is an employee, for example, if, by agreement, he or she:

• Does not take on outside duties that would negatively affect primary services to the hospital,
• Does not furnish services to other hospitals without the employer's consent,
• Obeys all rules and regulations of the hospital, and
• Receives a pay adjustment if the percentage of pay is less than an amount guaranteed by the agreement.

However, not all physicians who perform services for a hospital are employees. For example, a physician who performs services as a director of a hospital's department of pathology is not an employee if he or she:

• Receives a percentage of the department's income for the services,
• Pays an associate or substitute,
• Is allowed to privately practice medicine,
• Is not entitled to regular employee fringe benefits, and
• Is not subject to the general rules that apply to the hospital's employees.

Each case must be decided on its own facts and circumstances. No set rule will apply to all cases.

Ministers of Certain Employers
Beginning in 1997, a duly ordained or licensed minister of a church who is working as a minister or chaplain, but is self-employed or is working for an employer that is not a qualified tax-exempt organization, is treated as employed by a qualified tax-exempt organization for purposes of participating in a retirement income account (TSA plan).

Contributions
A TSA can be funded by the following contributions:

• Elective employer contributions (elective deferrals),
• Non-elective employer contributions,
Elective deferrals defined. Your employer’s plan may permit you to have part of your pay contributed by your employer to a retirement fund, rather than have it paid to you. These employer contributions are called “elective deferrals” because

1) You choose (elect) to set aside part of your pay, and

2) Payment of tax owed on that part of your pay is postponed (deferred) until it is distributed to you.

Non-elective employer contributions defined. An employer contribution to a TSA is treated as a non-elective contribution if employees are not required to choose the contributions. The employer chooses to make these contributions to the TSAs and generally must make them on behalf of all eligible employees. The employer must be a qualified employer (defined earlier) for the contributions to be excluded from the employee’s gross income. These contributions are subject to the limit on employer contributions discussed later.

After-tax employee contributions. If the plan permits these contributions, an employee contribution made with funds on which income taxes have already been paid is treated as an after-tax contribution. A salary payment on which income tax was withheld is an example of such funds. These contributions are subject to the limit on employer contributions.

Funding by elective deferrals. Employers contribute to a TSA primarily through a salary reduction agreement. (See Salary Reduction Agreement, later, for more information.) Under this agreement, you (the employee) agree to take a reduction in salary or your employer agrees to make the amount of the salary reduction or the foregone salary increase toward the purchase of your TSA. These employer contributions are excluded (within limits discussed next) from your income when made. The excluded amounts are included in your income when you withdraw them. These contributions generally are called “elective deferrals.” See Limit on Elective Deferrals, later, for more information.

Exclusion From Gross Income

Generally, if you are an eligible employee, you can exclude from gross income your qualified employer’s contributions to your TSA.

Exclusion Limits

The amount you exclude for a tax year cannot be more than any of the following limits:

1) The exclusion allowance (discussed later) for your tax year,

2) The annual employer contribution limit (discussed later) for the limitation year (discussed later) ending with or within your tax year, or

3) The limit on elective deferrals (discussed later) for the year.

For purposes of applying these limits, your employer’s contributions do not include a rollover contribution from another TSA or an individual retirement arrangement (IRA).

Alternative limits. You may be able to use an alternative limit to increase the amount you can exclude. See Catch-up Election — Alternative limits for Certain Employees, later.

Beginning in 1997, contributions made by a self-employed minister or chaplain who is treated as employed by a qualified tax-exempt organization to a retirement income account that is treated as a tax-sheltered annuity are deductible up to these limits for tax-sheltered annuities.

Treatment of excess contributions. If the contributions to your TSA for a year are more than any of the limits discussed above under Exclusion Limits, you must include the excess in your income for that year. Further, if you have an excess because the contributions are more than limit (2), that excess reduces the amount of your exclusion allowance for future years, even though the excess has already been included in your income.

For more information on the treatment of excess contributions, see Excess Deferrals, Limit on Employer Contributions, and Tax on Excess Contributions to a Custodial Account, later.

Only elective deferrals. If all of the contributions are elective deferrals, the total must not be more than the smallest of the three limits in the preceding list.

Only nonelective contributions. If all of the contributions are nonelective contributions, only limits (1) and (2) apply.

Both elective deferrals and nonelective contributions. If the total contributions include both elective deferrals and nonelective contributions and limit (3) is the smallest of the limits in the preceding list, the elective deferrals minus limit (3) is an excess deferral. The total of all contributions (including the elective deferrals) minus the smaller of limit (1) or (2) is an excess contribution.

More than one TSA. If for any tax year elective deferrals are contributed to more than one TSA for you (whether or not with the same employer), you must combine all the elective deferrals to determine whether the total is more than the limit for that year. See Limit on Elective Deferrals, later.

You can use the worksheets at the end of this publication to figure the following contribution limits that generally apply to you. For limit (1), use Worksheet 1. For limit (2), use Worksheet 2. For limit (3), use Worksheet 3. However, you may qualify to choose an alternative limit (worksheets 4, 5, or 6). See Catch-up Election — Alternative Limits for Certain Employees, later.

Salary Reduction Agreement

The most common way to contribute to TSAs is through a salary reduction agreement. A salary reduction agreement is an agreement between the employer and employee under which the employee agrees to take a reduction in salary or to forego a salary increase and the employer contributes that amount to a TSA for that employee.

You can enter into more than one salary reduction agreement during a tax year. In addition, for salary reduction purposes, you can use compensation that has not yet been made available to you. (However, to determine what compensation can be used to figure the maximum exclusion allowance, see Includable Compensation, later, under The Exclusion Allowance.)

Treatment of contributions. Amounts contributed by the employer under the salary reduction agreement and invested in a TSA for the employee are generally treated as elective deferrals (See Elective deferrals defined under Limit on Elective Deferrals later.)

Exemption. An employer contribution to a TSA is not treated as an elective deferral if it is made as a condition of employment or as a one-time choice by the employee when he or she first becomes eligible to participate in the agreement. But, if the employee can change or end the election to participate, the election is not a one-time choice and the contributions are elective deferrals.

Limit on Elective Deferrals

In addition to the exclusion allowance and the limit on employer contributions (these limits are discussed later), which apply to TSA contributions, there is an annual limit on combined elective deferrals. Elective deferrals are defined earlier under Contributions.

Deferrals subject to limit. The limit applies to the total of all elective deferrals contributed (even if contributed by different employers) for the year on your behalf to:

• Cash or deferred arrangements (known as section 401(k) plans) to the extent excluded from your gross income,

• Section 501(c)(18) plans created before June 25, 1959, and only to the extent excluded from your gross income,

• SIMPLE plans,

• Simplified employee pension (SEP) plans, and

• Tax-sheltered annuities.

Dollar limit. Generally, you cannot defer more than an allowable amount each year for all plans covering you, including TSAs. For 1997, the allowable amount (limit) is $9,500. (This limit applies without regard to community property laws.) If you defer more than the allowable amount for a tax year, you must include the excess in your gross income for that year (see Excess Deferrals, later).
**Increase for 15-year employees.** If you have a TSA and you have completed at least 15 years of service with an educational organization, hospital, home health service agency, health and welfare service agency, church, or any other organization or association of churches (or associated organization), the $9,500 limit for the TSA is increased each tax year. The limit is increased by the smallest of the following:

1) $3,000, or
2) $15,000, reduced by increases to the $9,500 limit you were allowed in earlier years because of this rule, or
3) $5,000 times the number of your years of service for the organization, minus the total elective deferrals made by the organization for you for earlier years.

For example, if you qualify, you may increase your elective deferrals to $12,500. For the computation, see Step 2 of Worksheet 3.

**Cost-of-living adjustment.** Under current law, the $9,500 limit is to be increased to reflect any increases in the Consumer Price Index in future years.

**WORKSHEET 3** at the end of this publication will help you figure the Limit on Elective Deferrals.

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**Excess Deferrals**

Excess deferrals are elective deferrals that exceed the limit on elective deferrals.

**Tax Treatment**

If the total you defer for a tax year is more than the limit for the year, you must include the excess in your gross income for that year on line 7 of Form 1040.

**Distribution of excess.** If the plan permits and you want to receive the excess amount, you must notify the plan as explained next.

**One plan.** If only one plan is involved, you must notify the plan by March 1 after the end of the tax year that an excess was deferred. The plan must then pay you the excess, along with any income on that amount, by April 15.

**More than one plan.** If more than one plan is involved, you must notify each plan by March 1 of the amount to be paid from that particular plan, and the plan must then pay you that amount, along with any income on that amount, by April 15.

If you take out the excess by the required date, do not include it again in your gross income and do not subject it to the additional 10% tax for premature distributions. However, any income earned on the excess that is taken out is taxable in the tax year you take it out.

If you take out part of the excess deferral and the income earned on it, you must treat the distribution as if ratably received from the excess deferral and the income earned on it. For example, assume that your excess deferral is $1,800 and the income earned on it is $200. If your distribution is $1,000, $900 is from the excess deferral and $100 is from the income earned that must be separately reported.

**Excess left in the plan.** If you leave the excess deferral in the plan, you must include the excess amount in your gross income for the tax year in which the amount was deferred. You cannot treat the excess amount as an investment in the contract (tax-free return of cost) when you figure the taxable amount of any future benefits or distributions. Thus, an excess deferral left in the plan would be taxed twice, once when contributed and again when distributed.

**Limit on Employer Contributions**

Limits are placed on the contributions that can be made by an employer to tax-sheltered annuity (TSA) programs for each limitation year. Every TSA is treated as a defined contribution plan for purposes of this limit (which is also called the "general rule"). Under the general rule, an employer’s contributions (including elective deferrals) to an employee’s account under a defined contribution plan should not be more than the lesser of:

1) $30,000, or
2) 25% of the employee’s compensation for the year.

This limit is in addition to the exclusion allowance (discussed later) and the limit on elective deferrals (discussed earlier). Also, see Catch-up Election — Alternative Limits for Certain Employees, later.

**WORKSHEET 2** at the end of this publication will help you figure the Limit on Employer Contributions and the amount you can exclude from gross income.

**Limitation year.** Generally, your limitation year is the calendar year. However, you can elect to change to a different limitation year consisting of a period of 12 consecutive months by attaching a statement to your individual income tax return for the tax year you make the change.

**Contributions in excess of employer limit.** An excess employer contribution must be included in your gross income in the tax year when it is made. For future tax years, the exclusion allowance must be reduced by this excess contribution even though it was not excludable from your gross income in the tax year when it was made.

**TSA and qualified plan.** If you must combine a TSA with a qualified plan, the limit is exceeded, the same rule applies. You must include the excess in your gross income for the tax year the excess contribution is made and reduce your exclusion allowance for any future years in which you are a participant in a TSA program.

If you are a participant in both a TSA program and a qualified plan, see Limit for Contributions to More Than One Program, later.

**Excess contribution in earlier years.** If in earlier years your employer made annual contributions to a TSA for you that were more than the annual maximum permitted under this limit on employer contributions, your exclusion allowance is reduced by the excess.

**Reduction procedure.** The exclusion allowance is reduced by including the excess contributions from prior years in amounts previously excludable, discussed later under The Exclusion Allowance. Include prior years’ excess contributions in amounts previously excludable only if the limit was exceeded for a tax year beginning after January 24, 1980.

**Compensation.** Generally, for the 25% limit (item (2) at the beginning of this discussion), compensation includes:

- Wages, salaries, and fees for personal services with the employer maintaining the plan, even if excludable as foreign earned income,
- Certain taxable accident and health insurance payments,
- Moving expense payments or reimbursements paid by employer if such payments are not deductible by you, and
- The value of nonqualified stock options granted to you that are includible in your gross income in the year granted.

Generally, compensation does not include:

- Contributions toward a tax-sheltered annuity contract,
- Contributions toward a deferred compensation plan if, before applying the limit on employer contributions, the contributions are not taxable,
- Distributions from a deferred compensation plan,
- Proceeds from the disposition of stock acquired under a qualified stock option, and
- Certain other amounts that are excludable from your income, such as group term life insurance premiums that are not taxable.

**More than one annuity contract.** For each year you apply this limit, you must combine the contributions to all TSAs made on your behalf by your employer. This is done whether or not you elect one of the alternative limits discussed under Catch-up Election — Alternative Limits for Certain Employees, later. You may also have to combine contributions to qualified plans of the same employer or an employer that you control (for purposes of applying this limit). See Limit for Contributions to More Than One Program, later.

**The Exclusion Allowance**

The exclusion allowance is the amount of employer contributions (including elective deferrals) to your tax-sheltered annuity (TSA) that you can exclude from income. You pay tax on these excluded amounts when you receive a distribution from the TSA.

**More than one TSA.** If, during any tax year, you have two or more TSA contracts, custodial accounts, or retirement income accounts maintained by your employer, figure only...
one exclusion allowance for the TSAs because you must consider them as one TSA.

More than one employer. If more than one qualified employer contributes to a TSA for you, you must figure a separate exclusion allowance for each qualified employer. Do not include amounts contributed, compensation, or years of service for one qualified employer in the computation for another qualified employer. Special rules apply to church employees, as discussed under Years of Service, later.

Employer must remain qualified. The exclusion allowance applies only to those contributions made while your employer was a qualified employer. If, for example, your employer loses tax-exempt status and is no longer qualified, your exclusion allowance will not apply to the employer’s contributions made after losing the exemption.

How to Figure
You determine the exclusion allowance at the end of your tax year as follows:

1) Includible compensation (discussed later) ........................................ $ ........................$
2) Percentage limit ............................................................. 20% ........................................................................
3) Years of service (discussed later) ...................................................... $ ........................$
4) Multiply (1) × (2) × (3) .......................................................... $ ........................$
5) Minus: Amounts previously excludable (discussed later) ................... $ ........................$
6) Exclusion allowance (before reduction for any excess contributions) ................................................. $ ........................$

Reduction of the exclusion allowance.
You must reduce your exclusion allowance by the amount that your employer’s contributions (for tax years beginning after January 24, 1980) were more than the limit on employer contributions for those years. (See Contributions in excess of employer limit under Limit on Employer Contributions, earlier.) For future years, treat the excess as though it were an amount previously excludable.

Example. At the end of 1997, you had completed 3 years of service with your employer. Your salary for 1997 was $32,000 after being reduced under a revocable salary reduction agreement by $3,600 to finance your employer’s contributions toward the purchase of a TSA for you. Your employer’s contributions for the year totaled $3,600, $100 of which was for current term life insurance protection.

In previous years, your employer’s contributions to the regular retirement plan totaled $7,200, all of which you properly excluded from gross income. You figure your exclusion allowance (the amount excludable from gross income) and the amount of any employer contributions includible in your gross income for 1997 as follows:

Step 1—Limit on Employer Contributions

1) a) Maximum ......................................................... $30,000
   b) 25% of employee’s compensation (25% × $32,000 = $8,000) ......................... $8,000
   c) Limit (Lesser of (a) or (b)) ....................................................... $8,000

2) Included in your gross income.

Beginning in 1998, contributions made to a church plan on behalf of a duly ordained, commissioned, or licensed minister employed by an employer other than the church are excluded from the minister’s gross income if they would have been excluded had the minister been an employee of the church.

For purposes of this rule, a minister of a church also includes:

1) A self-employed minister, and

2) Includible in your gross income.

Beginning in 1998, for purposes of figuring your exclusion allowance, which is the amount of employer contributions (including elective deferrals) to your tax-sheltered annuity that you can exclude from income, your includible compensation includes:

1) Elective deferrals (employer’s contributions made on your behalf under a salary reduction agreement),
2) Amounts contributed or deferred by your employer under a Section 125 cafeteria plan, and
3) Amounts contributed or deferred under a Section 457 nonqualified deferred compensation plan (state or local government or tax-exempt organization plan).

Self-employed ministers. Beginning in 1997, compensation of a self-employed minister who is treated as employed by a tax-exempt organization, is the minister’s earnings from self-employment reduced by contributions to retirement plans and the deduction for one-half of the self-employment tax.

Special Rules
When figuring your includible compensation you should examine the following exceptions and definitions.

Employer not qualified. Only the compensation earned from the qualified employer purchasing your TSA contract can qualify as includible compensation. Do not count compensation earned while your employer was not a qualified employer. However, your employer’s status when you actually receive the compensation does not matter.

Other employers. Compensation from other employers who either are not qualified or are not purchasing your TSA contract, and compensation from other sources generally is not includible compensation. However, see Service with one employer, under Years of Service, later.

Contributions for a TSA. Contributions by your employer (including elective deferrals) for a tax-sheltered annuity are not part of includible compensation.

However, if you are a foreign missionary during the tax year, your includible compensation includes contributions by the church during the year toward your tax-sheltered annuity.

You are a foreign missionary if your principal duties are spreading religious doctrine or performing sacred liturgical functions or humanitarian good works for the church outside the United States.

Catch-up election for certain employees. Certain employees can elect to substitute the limit on employer contributions for the exclusion allowance under an alternate rule called the Overall Limit (explained under Catch-up Election — Alternative Limits for Certain Employees, later). Only employees of educational organizations, hospitals, home health service agencies, health and welfare service agencies, churches, and certain church-related organizations can make the election.

Minimum exclusion allowance for church employees. If you are a church employee (defined later under Years of Service) and your adjusted gross income (figured without regard to community property laws) is not more than $17,000, you are entitled to exclude from your gross income a certain minimum amount called a minimum exclusion allowance. The minimum is your exclusion allowance figured as explained earlier, but not less than the smaller of:

1) $3,000, or
2) Your includible compensation (defined next).

Includible Compensation
As a first step in figuring your exclusion allowance for a tax year, you must figure 20% of your includible compensation.

Generally, your includible compensation is the salary (not including employer contributions to your TSA) from your employer who made contributions to your TSA that is:

1) Earned during your most recent period that may be counted as one year of service, and

WORKSHEETS 1 through 6 at the end of this publication will help you figure the amount of employer contributions that you can exclude from gross income and the amount you must include.

TIP

Beginning in 1998, contributions made to a church plan on behalf of a duly ordained, commissioned, or licensed minister employed by an employer other than the church are excluded from the minister’s gross income if they would have been excluded had the minister been an employee of the church.

For purposes of this rule, a minister of a church also includes:

1) A self-employed minister, and

2) Includible in your gross income.
2) A minister employed by an organization other than a tax-exempt organization that shares a common religious bond with the minister.

Contributions to a TSA and a qualified retirement plan. If your employer makes contributions for you toward both a TSA contract and a qualified retirement plan, the contributions to the qualified retirement plan are not part of includible compensation for figuring your exclusion allowance.

Contributions that are more than your exclusion allowance. Contributions that are more than your exclusion allowance are not part of compensation for figuring your exclusion allowance, but they must be included in your gross income.

Example. After taking a reduction in salary to pay for your employer’s contribution for an annuity during your first year of employment, you received a salary of $12,000. According to your agreement, $2,800 ($400 more than your exclusion allowance) is contributed for your annuity. Use $12,000 as includible compensation in figuring the exclusion allowance, even though you must include $12,400 in gross income.

The cost of incidental life insurance. The cost of incidental life insurance provided under a TSA contract is not includible compensation even though this cost is taxable to you. This part of the cost of your TSA contract is treated as contributed by you, rather than by your employer, and is part of your cost (basis) in the contract.

Foreign earned income exclusion. Excludable foreign earned income is part of includible compensation.

Most Recent One-Year Period of Service
Your includible compensation is only the compensation earned during your most recent period of service that ends on or before the end of the tax year for which the exclusion allowance is being determined. The period must be a full year of service if the total time you worked for your employer equals at least one full year. A part-time employee or a full-time employee who works part of a year, discussed below, must combine earnings for fractional parts of a year until they equal a full year’s earnings. Your most recent period of service will include more than one tax year if you were a part-time employee or if you were a full-time employee who worked only part of a tax year. If you worked for your employer at least one full year over a period of more than one tax year.

If you worked less than a full year for your employer by the end of a tax year for which you are figuring the exclusion allowance, consider the actual period of your employment as your most recent one-year period of service for figuring your includible compensation.

For example, if you became employed on October 1, 1997, your most recent one-year period of service for figuring your includible compensation for your 1997 exclusion allowance is the period from October 1 through December 31, 1997. If your annual salary is $20,000, your includible compensation would be $5,000 (1/4 of $20,000).

Earned in a prior tax year. Your includible compensation may include all or part of your compensation earned in a tax year before the one for which the exclusion allowance is being determined. What is important is that you were employed in the service, not when you actually receive the compensation or the tax year in which it is includible in your gross income.

For example, if you are figuring your exclusion allowance for your 1997 tax year, and you worked full time for your employer for all of 1996 and 1997, your includible compensation will include the amounts earned in 1996 and 1997.

In figuring your includible compensation, you must first take into account the service you performed during the tax year for which the exclusion allowance is being determined. Therefore, your most recent one-year period of service may not be the same as your employer’s most recent annual work period.

Example. You are employed as a professor at a university and you use the calendar year as your tax year. You are employed on a full-time basis during the university’s 1996–97 and 1997–98 academic years (October through May). The academic year of the university is 8 months long, beginning in October and ending the following May. You are considered as having completed four-eighths of a year of service.

Full-time employee for a part of a year. If you were a full-time employee for a part of a year, your most recent one-year period of service includes the service you performed in the period 1994 through 1997, figured as follows:

1997 fractional period of service .................. 1/4
1996 fractional period of service .................. 1/4
1995 fractional period of service .................. 1/4
1994 fractional period of service .................. 1/4
1 year of service equals .................................. 4/4

Part-time employee for a part of a year. If you are a part-time employee for a part of a year, the numerator of the fraction that represents your fractional year of service is the number of weeks (or months) that you were a full-time employee during that year. The denominator is the number of weeks (or months) considered to be the usual work period for your position.

Example. You are employed full time as an instructor by a university for the 1997 spring semester (which lasts from February through May). The academic year of the university is 8 months long, beginning in October and ending the following May. You are considered as having completed four-eighths of a year of service.

Part-time employee for a full year. If you are a part-time employee for a full year, the numerator of the fraction that represents your fractional year of service is the amount of work you are required to perform. The denominator is the amount of work normally required of individuals who hold the same position.

Example. You are a practicing physician teaching one course at a local medical school 3 hours a week for two semesters. Other faculty members at that medical school teach 9 hours a week for two semesters. You are considered to have completed three-ninths of a year of service.

Part-time employee for part of a year. If you are a part-time employee for part of a year, you figure the fraction that represents your fractional year of service by:

1) Figuring a fractional year as if you were a full-time employee for part of a year;

2) Figuring a fractional year as if you were a part-time employee for a full year, and

3) Multiplying the fractions in (1) and (2).

Example. You are an attorney and a specialist in federal tax law. In addition to your private practice, you teach tax law for 3 hours a week for one semester (the 4-month spring
Part-time or full-time employee for part of a year. You must figure the fraction that represents your fractional year of service. The rules for doing this are the same as those for figuring your Most Recent One-Year Period of Service, discussed earlier.

Amounts Previously Excludable
The next step in figuring your exclusion allowance is to subtract the amounts previously excludable from the result of multiplying 20% of includable compensation by your years of service.

Amounts previously excludable defined.
Amounts previously excludable refers to the total of all contributions for retirement benefits made for you by your employer that were excludable from your gross income. Include only amounts for tax years before the one for which the current exclusion allowance is being figured.

Amounts previously excludable include contributions in earlier years by your employer to:
- A tax-sheltered annuity,
- A qualified annuity plan or a qualified pension, profit-sharing, or stock bonus trust,
- A qualified bond-purchase plan,
- A retirement plan under which the contributions originally were excludable by you only because your rights to the contributions were forfeitable when made, and which also were excludable by you when your rights became nonforfeitable (This does not apply to contributions made after 1957 to purchase an annuity contract if your employer was an exempt organization when the contributions were made.), or
- An eligible deferred compensation plan (under Code section 457) of a state or local government or tax-exempt organization, even if maintained by a separate employer.

You must treat contributions to a state or local government or tax-exempt organization as part of your excludable compensation even if made by a separate employer.

You must treat employer contributions and other additions in earlier years (beginning after January 24, 1980) that were more than the limit as if they were amounts previously excludable. See Limit on Employer Contributions, earlier.

Contributed amount unknown.
If you do not know the amount that an employer contributes to a plan on your behalf you can figure your part of your employer's contributions by any method using recognized actuarial principles that are consistent with your employer's plan and the method used by your employer for funding the plan. You may also use the following formula.

Formula to figure. The contributions your employer made for you as of the end of any tax year are the result of multiplying the following four items:

1) The projected annual amount of your pension (as of the end of the tax year) to be provided at normal retirement age from employer contributions, based on your plan in effect at that time and assuming your continued employment with that employer at your then current salary rate;
2) The value from Table I based on the normal retirement age as defined in the plan;
3) The amount from Table II for the sum of the following two items:
   a) The number of years remaining from the end of the tax year to normal retirement age, plus
   b) The lesser of the number of years of service credited through the end of the tax year or the number of years that the plan has been in existence at that time, and
4) The lesser of the number of years of service credited through the end of the tax year or the number of years that the plan has been in existence at that time.

An example of the use of these four items to figure an employer's contribution for you for a year follows Table I and Table II.

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Table II

[Value at normal retirement ages of annuity of $1 per year payable in equal monthly installments during the life of the employee.]

Note: If the normal form of retirement benefit under the plan is other than a straight-life annuity, divide the value from Table I by the appropriate factor as follows:
Amount

Normal retirement age is 65.

This is based on 1996 plan provisions and assumes that Joe works for the same employer until age 65 at his 1996 salary. Normal retirement age is 65.

Joe figures the amounts previously excludable under the pension plan as follows:

A. Projected annual amount of pension at normal retirement age (65) $12,000

B. Table I value at normal retirement age (65) 8.08

C. Table II amount of:
   1) Number of years from end of the preceding tax year (1996) to normal retirement age (65 minus 28) 37
   2) Plus: Lesser of years of plan existence or years of service 3

= 40

D. Lesser of years of plan existence or years of service 3

Joe multiplies A times B times C times D. $12,000 x 8.08 x .0039 x 3 = $1,134.43

Joe then adds $1,134.43 to the amounts ($7,200) contributed to the tax-sheltered annuity plan in years prior to the 1997 tax year to determine the amounts previously excludable of $8,334.43.

Note: See Contributions in excess of employer limit, earlier under Limit on Employer Contributions.

Catch-up Election — Alternative Limits for Certain Employees

If you are an employee of an educational organization, a hospital, a home health service agency, a health and welfare service agency, or a church or church-related organization that contributes to a tax-sheltered annuity (TSA) for you, you may make a “catch-up” election (see Background, later) to increase the limit on your employer’s contributions by using one of three alternative limits.

Eating (choosing) a limit. You can elect any one of the three limits, but with certain restrictions, as explained later under Making the Election. For example, you cannot make more than one election and, once one is made, it is irrevocable and limits elections for future years.

Effect of election. Generally, the election to use one of the first two alternative limits listed above will permit you to exclude from gross income a larger amount of employer contributions than allowed under the part of the “overall limit” that limits employer contributions to 25% of your compensation. The overall limit is sometimes referred to as the general rule (discussed earlier under Limit on Employer Contributions).

Excess contributions. If employer contributions are included in your income for a tax year because they exceed any of these alternative limits for that year, the excess reduces the amount of your exclusion allowance for future years, even though the excess has already been included in your income.

Year of Separation from Service Limit

For the limitation year (defined under Limit on Employer Contributions, earlier) that ends with or within the tax year you separate from the service of an educational organization, hospital, church, or other organization listed above, you can elect to substitute your exclusion allowance (modified as discussed below) for the 25% of your compensation limit on employer contributions under the general rule. (See Limit on Employer Contributions, earlier.) The $30,000 limit on employer contributions still applies. The limit on elective deferrals also still applies to the extent the contributions consist of elective deferrals. See Limit on Elective Deferrals, earlier.

Figuering the limit.

Figure your exclusion allowance as explained earlier, except, for your years of service, count only the service you performed during your 10-year period ending on the date of separation. Do not use a period longer than 10 years even if the 10-year period is less than your actual number of years of service. Your amounts previously excludable are the amounts excludable during your years of service (limited to 10 years). All service for your employer performed within the 10-year period must be taken into account.

Limit. Compare this modified exclusion allowance to the $30,000 limit on employer contributions and the limit on elective deferrals, if it applies. Your year of separation from service limit is the least of these.

If your employer’s contributions for the year are more than the least of:

1) Your modified exclusion allowance,

2) $30,000, or

3) The limit on elective deferrals, if it applies,

Example. Joe Blue, who was 29 at the end of 1997, has been employed by the Oak County school system since 1994. In 1994, Joe’s employer contributed to a TSA program. Since 1994, Joe’s employer has contributed to both the TSA program and a statewide retirement system that provides a straight-life annuity upon retirement. Joe is covered by both plans.

For 1997, Joe wishes to figure the amounts previously excludable under both plans so that he can figure the exclusion allowance for that year. His employer’s contributions to the statewide retirement system were not allocated among the individual employees.

Joe’s employer gives him the following information:

Employer contributions to the TSA that were excludable from gross income in prior years:

1994 $2,000

1995 2,400

1996 2,800

The projected annual amount of Joe’s retirement system pension (as of the end of 1996 when Joe was 28) is $12,000. The pension begins at age 65 from his employer’s contributions. This is based on 1996 plan provisions and assumes that Joe works for the same employer until age 65 at his 1996 salary. Normal retirement age is 65.

Table II

[Level annual contribution which will accumulate to $1.00 at the end of a number of years.]

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Note: See Contributions in excess of employer limit, earlier under Limit on Employer Contributions.

Special Election for Church Employees, later.
you must include the excess in gross income.

Example. Frank Green, who is president of a university, plans to retire on December 31, 1997, after 20 years of service. His compensation for 1997, which was not reduced for any elective deferrals, is $100,000. During the 10-year period before the date of separation from service, Frank’s employer contributed $40,000 to Frank’s TSA. The contributions, which were non-elective, were excludable from Frank’s gross income. For 1997, Frank elected to have his employer contribute the maximum amount permitted for non-elective employer contributions to his TSA. He figures that amount using the Year of Separation from Service Limit as follows:

Step 1—Exclusion Allowance (before modification)
1) Includible compensation $100,000
2) Percentage limit .20
3) Years of service 20
4) Multiple (1) × (2) × (3) $400,000
5) Minus: Amounts previously excludable $60,000
6) Exclusion allowance $340,000

Step 2—Limit on Employer Contributions
1) Maximum $30,000
2) 25% of compensation limit
   a) Compensation $100,000
   b) Percentage limit 25
   c) Limit $25,000
3) Limit on Employer Contributions
   (lesser of (1) or (2)) $25,000

Step 3—Year of Separation from Service Limit
1) Employer Limit on Contributions — $30,000
2) Exclusion allowance (modified)
   a) Includible compensation $100,000
   b) Percentage limit .20
   c) Years of service 10
   d) Multiply (a) × (b) × (c) $20,000
   e) Minus: Amounts previously excludable during 10-year period .40,000
   f) Exclusion allowance (modified) $160,000
3) Alternative Limit — Year of Separation from Service Limit [lesser of (1) or (2) or (3)] $30,000

Because Frank elected this alternative limit, and because there are no elective deferrals, his employer can contribute $30,000 to Frank’s TSA during the year of his separation from service without making an excess contribution. In Step 1, Frank’s unadjusted exclusion allowance is $340,000. In Step 2, employer contributions to Frank’s TSA are limited to $25,000. If it were not for this election, the limit on employer contributions for Frank would be $25,000 (Step 2). Instead, the limit is $30,000.

Any Year Limit
For any limitation year (defined under Limit on Employer Contributions, earlier), you can substitute for the 25% of employee’s compensation limit the least of the following:
1) $4,000 plus 25% of your includible compensation for the tax year in which the limitation year ends;
2) The exclusion allowance for the tax year in which the limitation year ends; or
3) $15,000.

If you elect this limit, the maximum permitted contribution to your TSA is $15,000, not the $30,000 that may apply under other limits.

If your employer’s annual contributions are more than the least of:
1) Your Any Year Limit,
2) Exclusion allowance, or
3) The limit on elective deferrals (to the extent the contributions are elective deferrals),
you must include the excess in your gross income.

Example. Bill Black is a principal with the Maple County school system. In 1997, his 17th year of service, Bill’s salary is $30,000 without reduction for a salary reduction agreement. Bill’s employer had contributed $34,400 to the tax-sheltered annuity program in earlier years and all the contributions were excluded from Bill’s income. Under a salary reduction agreement, Bill and his employer agree to elective deferral contributions of $9,500 that may be excluded from Bill’s gross income. To find the maximum employer contribution allowed, Bill figured the Any Year Limit as follows:

Step 1—Exclusion Allowance
1) Includible compensation $30,000
2) Percentage limit .20
3) Years of service 17
4) Multiply (1) × (2) × (3) $102,000
5) Minus: Amounts previously excludable 34,400
6) Exclusion allowance $67,600

Step 2—Any Year Limit
7) a) $4,000 plus 25% of includible compensation ($4,000 + $7,500 (25% × $30,000)) $11,500
   b) Exclusion allowance (from Line (6)) $67,600
   c) Maximum under this election $69,100
   d) Alternative limit (Least of (a), (b), or (c)) $67,600

Under this alternative limit, Bill’s employer can contribute $11,500 to the annuity program.

Example. Mary White is employed as a nurse with Apple City General Hospital. In her 11th year of service, she agreed to have her employer contribute additional amounts to her tax-sheltered annuity program for catch-up contributions. Her compensation for 1997 is $35,000. She figures the overall limit on contributions to be $8,750, as follows:
1) Maximum employer contributions $30,000
2) 25% of compensation ($25,000) $8,750
3) Overall limit on employer contributions— (lesser of (1) or (2)) $8,750

Examples of Catch-up Elections
The following examples show how you can use the three alternative limits just discussed to maximize the amount of employer contributions to a tax-sheltered annuity (TSA) that you can exclude from income.

Example 1. Eli Green was an employee of Maple Hospital, a tax-exempt charitable organization, for the entire 1997 calendar year. His employer’s contributions to a TSA for him are not subject to the elective deferral limit. Eli has a salary of $30,000 for the year. He has 4 years of service with his employer as of December 31, 1997. During Eli’s prior service with Maple Hospital, his employer had contributed $12,000 on Eli’s behalf to a TSA, and Eli excluded the amount from gross income in earlier years. Thus, for 1997, Eli’s exclusion allowance is $12,000, figured as follows:

Worksheet 5 at the end of this publication will help you figure the Any Year Limit and the amount you can exclude from gross income.

Overall Limit
You can elect to have the limit on your employer’s contributions and your exclusion allowance be equal to the lesser of $30,000 or 25% of compensation (See Compensation under Limit on Employer Contributions, earlier, for the limitation year ending in the tax year. Under this election, you disregard the computation of the exclusion allowance discussed under The Exclusion Allowance, earlier.

Include in your gross income any contribution to your TSA that is more than the lesser of the limit on employer contributions ($30,000 or 25% of compensation) or the elective deferral limit ($9,500), if it applies.

If you elect the Overall Limit as your alternative limit, you must combine employer contributions to your TSA with your employer’s contributions to a qualified plan to determine whether the limits on employer contributions have been exceeded. See Limit for Contributions to More Than One Program, later.

Worksheet 6 at the end of this publication will help you figure the Overall Limit and the amount you can exclude from gross income.
1) Includible compensation .............................. $30,000
2) Percentage limit .................................. 20%
3) Years of service .................................. 4
4) (1) × (2) × (3) ........................................... $24,000
5) Minus: Amounts previously excludable ........ 12,000
6) Exclusion allowance ................................ $12,000

The limit under the general rule (see Limit on Employer Contributions, earlier) is $7,500 (the lesser of $30,000 or $7,500 (25% × $30,000)).

Without the catch-up elections provided for certain employees, $7,500 would be the maximum contribution Maple Hospital could make for TSAs on behalf of Eli for 1997 without increasing Eli's gross income for that year.

Since Eli is an employee of a hospital, he can elect one of the catch-up limits. Eli can elect either the Any Year Limit or the Overall Limit. He cannot elect the Year of Separation from Service Limit since he does not separate from service in 1997.

If Eli elects the Any Year Limit, Maple Hospital could contribute $11,500 on his behalf for 1997 to a TSA, figured as follows:

1) $4,000, plus 25% of includible compensation
2) Exclusion allowance ................................ $11,500
3) Maximum ............................................. $15,000
4) Any year limit [least of (1), (2), or (3)] .......... $11,500

If Eli elects the Overall Limit, Maple Hospital could contribute only a maximum of $7,500 without increasing Eli's gross income for the year figured as follows:

1) Maximum ............................................. $30,000
2) 25% of compensation ................................ $7,500
3) Overall limit [lesser of (1) or (2)] .......... $7,500

Example 2. Assume the same facts as in Example 1, except that Maple Hospital contributed $18,000 on Eli's behalf in earlier years to the TSA. The contributions were excludable from his gross income. Thus, for 1997, Eli's exclusion allowance is $6,000 figured as follows:

1) Includible compensation .............................. $30,000
2) Percentage limit .................................. 20%
3) Years of service .................................. 4
4) (1) × (2) × (3) ........................................... $24,000
5) Minus: Amounts previously excludable ........ 18,000
6) Exclusion allowance ................................ $6,000

Without the catch-up elections, $11,000 would be the maximum excludable contribution Elm School could make to a TSA on Behalf of Bob's behalf for 1997. This is the least of the exclusion allowance ($108,000), the general rule ($11,000), or the increased elective deferral limit ($15,000). How- ever, because Bob was an employee of an educational organization and has separated from service, he can elect any one of the three catch-up elections (alternative limits) to increase his allowable 1997 contribution.

Before deciding which catch-up election to make, Bob considers the following:

If Bob elects the Year of Separation from Service Limit for 1997, Elm School could contribute up to $30,000, or $11,000 for the year, even if this is more than 25% of his compensation for the year. The total contributions over your lifetime under this election cannot be more than $40,000. In this situation, the exclusion allowance limit still applies, unless you also elect the Overall Limit, described earlier. If the contributions are elective deferrals, they are also subject to the limit on elective deferrals, discussed earlier.

You cannot make this special election for a tax year in which you use the Year of Separation from Service Limit, described earlier.

Making the Election
You make the election to apply one of the three alternative limits by figuring your tax using the limit you choose. However, the election is treated as made only when needed to support the exclusion from gross income reflected on the income tax return.

Election is irrevocable. If you elect to use an alternative limit, you cannot change the election.

If you elect one of the alternative limits, you cannot elect to have any of the others apply for any future year for any TSA purchased for you by any employer.

If you elect the Any Year Limit or the Overall Limit, it is the only alternative limit you can use for later years.

Failure to pay estimated income tax. If you amend an earlier year's return to elect an alternative limit, and that limit increases your tax for that year, the difference in tax due to the use of the alternative limit is not treated as an underpayment of tax for the penalty for failure to pay estimated income tax.
Limit for Contributions to More Than One Program

Special rules may apply in determining the limit on employer contributions for you to a tax-sheltered annuity (TSA) program if you also are covered by a qualified plan.

Combining contributions. Generally, contributions to TSA programs must be combined with contributions to qualified plans of all corporations, partnerships, and sole proprietorships in which you have more than 50% control to determine whether the limits on contributions and benefits of qualified plans (section 415 limits) have been exceeded.

If you elect the Overall Limit, discussed earlier, you must combine contributions whether or not you have this control.

Example 1. You have an HR–10 plan (sometimes called a Keogh plan) for a sole proprietorship, and you are also a participant in a charity’s TSA program. You must combine contributions under the two defined contribution plans to determine whether the limit on employer contributions is satisfied.

Example 2. You are employed by an educational organization that provides a TSA program. You are also a shareholder owning more than 50% of a professional corporation. You must combine any qualified plan of the professional corporation with the TSA to determine if the section 415 limits have been satisfied.

Excess contributions. If you combine the TSA contract and a qualified plan, the limit on employer contributions may be exceeded. The excess is includible in your gross income for the tax year the excess contribution was made, and it reduces your exclusion allowance for all future years.

How to figure tax. You figure the excess contributions tax for the current year as follows:

1) Total amount contributed for current year, minus rollovers ...........................................
2) Lesser of exclusion allowance or annual limit on employer’s contributions .......................... 
3) Current year excess contributions (line 1 minus line 2, but not less than zero) ......................... 
4) Preceding year excess contributions not previously eliminated. If zero, proceed to line 8 .................................................................................. 
5) Contribution credit (if line 2 is more than line 1, enter the excess, otherwise enter zero) .............. 
6) Total of all prior years’ distributions out of the account included in your gross income (not including amounts received as an annuity and not previously used to reduce excess contributions) ........................................
7) Adjusted preceding year’s excess contributions (line 4 minus the total of lines 5 and 6) ..................
8) Taxable excess contributions (line 3 plus line 7) ......................................................................
9) Excess contributions tax—Enter the lesser of 6% of line 8 or 6% of the value of your account as of the last day of the year ..........................................................

Other Rules

The following additional rules generally relate to contributions to your tax-sheltered annuity (TSA), and to other transactions affecting your annuity before you retire or receive annuity benefits.

Voluntary Employee Contributions

You cannot deduct voluntary employee contributions you make to your TSA. However, there may be amounts in your TSA that are from deductible voluntary employee contributions you made in earlier years. If these amounts are distributed to you, you must include them in gross income unless you roll them over into an IRA or into another TSA.

Tax on Excess Contributions to a Custodial Account

You are liable for a 6% excise tax on contributions in excess of the exclusion allowance or the limit on employer contributions made under a TSA plan investing in mutual fund shares through a custodial account. The tax does not apply to excess contributions made to pay premiums on an annuity contract. Also see Taxability of Excess Contributions, later.

You cannot deduct the tax. It is due each year until the excess contribution is corrected. Excess contributions may be corrected by contributing less in future years. For example, if there is an excess contribution in 1997 and no corrective action is taken for that year, you are liable for the tax for 1997. If after 1997 you do not withdraw the excess (if not otherwise restricted) or reduce it by carrying it over to a later year (or years) in which you contribute less than your allowable contribution for that later year (or years), you will continue to be liable for the tax on the excess each year it remains. This tax will be in addition to any tax due because of additional excess contributions in a later year.

Cost of Insurance Protection

If your annuity contract provides you with incidental life insurance protection, you must include in your income each year the one-year cost of the life insurance premium. This cost should be included with salaries and wages on Form W–2.

Your current life insurance protection under an ordinary retirement income life insurance policy is the amount payable upon your death minus the cash value of the contract at the end of the year.

Example. Your new contract provides that your beneficiary will receive $10,000 if you should die anytime before retirement, and your cash value in the contract at the end of the first year is zero. Your current life insurance protection for the first year is $10,000 ($10,000 minus 0).

The one-year cost of the protection can be figured by using the following table. The premium rate is determined according to your age on your birthday nearest the beginning of the policy year.

If the current published premium rates per $1,000 of insurance protection charged by an insurer for individual one-year term life insurance premiums available to all standard risks are lower than those in the following table, you can use the lower rates for figuring the cost of insurance in connection with individual policies issued by the same insurer.

Uniform One-Year Term Premiums for $1,000 Life Insurance Protection

(Based on Table 38, U.S. Life Table and Actuarial Table (U.S. Government Printing Office, Washington, D.C.—1946), and 2½% interest.)

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Reporting requirement. You must file Form 5330, Return of Excise Taxes Related to Employee Benefit Plans, if there has been an excess contribution to a custodial account and that excess has not been corrected in any year.

When to file. File Form 5330 by July 31 following the close of your tax year. You may be granted an extension (not to exceed 6 months) by filing Form 5558, Application for Extension of Time To File Certain Employee Plan Returns, early enough to give IRS time to consider and act on it before the due date of Form 5330.

Where to file. You should file Form 5330 with the Internal Revenue Service Center where you normally file your income tax return.

Example. Lynn Green and her employer enter into a tax-sheltered annuity purchase agreement that will provide her with a $500 a month annuity upon retirement at age 65. The agreement also provides that if she should die before retirement, her beneficiary will receive the greater of $20,000 or the cash...
surrender value in the retirement income life insurance contract.

Since the cash surrender value at the end of the first year is zero, her net insurance is $20,000 ($20,000 minus 0). Her age on the nearest birthday is 44. Using the preceding table, she determines that her one-year term premium cost for $1,000 of insurance is $5.85. Thus, she must include in gross income $117.00 ($5.85 × 20) as the premium for her net insurance coverage of $20,000.

Lynn’s cash value in the contract at the end of the 2nd year is $1,000. Thus, her life insurance coverage is $19,000 ($20,000 minus $1,000). Since the one-year term cost rate per $1,000 for age 45 in the 2nd year is $8.30, the amount to be included in income is $119.70 ($8.30 × 19).

Federal Insurance Contributions Act (FICA)
The contributions toward the tax-sheltered annuity (TSA) under a salary reduction agreement are considered wages for the FICA (social security and Medicare) tax. The employer must take into account the entire amount of these contributions for FICA tax purposes, whether they are wholly or partially excludable for income tax purposes. These wages are credited to the employee’s social security account for benefit purposes.

However, if the employer makes a contribution to purchase an annuity, which is not under a salary reduction agreement, that amount is not considered wages for social security tax purposes.

Religious exemption. A church or church-related organization may have chosen, for religious reasons, to have its employees be exempt from the FICA tax on all their earnings from that employment, including any TSA contributions. If this choice is in effect, the wages from church employment are generally subject to the self-employment tax (SECA) discussed next.

Self-Employment Contributions Act (SECA)
Generally, a person who renders services to a church as a minister is treated as a self-employed individual for the social security and Medicare self-employment tax, even though the minister may be an employee for other tax purposes.

Certain income not taken into account.
For social security and Medicare tax purposes (assuming the minister does not elect to be exempt from social security), some items of income excludable from the minister’s gross income are not taken into account in determining the net earnings from self-employment. Contributions for the minister toward a tax-sheltered annuity (TSA) contract are not taken into account as net earnings from self-employment to the extent the contributions are not more than the exclusion allowance or employer contribution limit.

Effect of FICA tax exemption.
If you are an employee of a church or church-related organization and you chose exemption from FICA tax, as mentioned above, you must include wages from that employment in net earnings from self-employment. However, do not include TSA contributions in figuring self-employment tax. The self-employment tax on wages from church employment is figured under special rules. See Schedule SE (Form 1040) and its instructions.

For information on FICA and SECA taxes, get Publication 517, Social Security and Other Information for Members of the Clergy and Religious Workers.

Reporting by Employer
If you participate in a tax-sheltered annuity (TSA) plan, your employer must report this participation by checking the “Pension plan” box on the Form W–2, Wage and Tax Statement, given to you and the IRS after the end of the year. If you have an individual retirement arrangement (IRA) and you or your spouse participate in a TSA or certain other retirement plans, the deduction for your IRA contributions may be reduced or eliminated. See information on IRAs, get Publication 590, Individual Retirement Arrangements (IRAs).

Also, your employer must report in box 13 of your Form W–2 your total elective deferrals, including any excess contributions to a TSA.

Employers and plan administrators must report contributions in excess of the limits that apply. Form 1099–R includes boxes for reporting “gross” and “taxable” amounts of total distributions.

Reporting by Self-Employed Minister or Chaplain
For 1997, contributions made by a self-employed minister or chaplain, who is treated as employed by a qualified tax-exempt organization, to a retirement income account that is treated as a tax-sheltered annuity must be reported as a deduction by the individual making the contributions.

Self-Employed Minister
A self-employed minister can report these contributions on line 28 of Form 1040.

Chaplain
A chaplain, who is not self-employed (an employee) can report these contributions on line 31 of Form 1040.

Income Tax Withholding by Employer
Your employer’s contributions to your tax-sheltered annuity, to the extent excludable from your gross income, are not subject to income tax withholding. However, any amount contributed to the plan in excess of the applicable limits, or used to purchase current life insurance protection, is subject to withholding.

Taxability of Excess Contributions
If your employer makes contributions to (pays the premium for) a tax-sheltered annuity contract for your benefit, the contributions are taxable to the extent they are more than the amount excludable from your gross income (see Exclusion from Gross Income, earlier), but only to the extent they are (or become) substantially vested at the time of payment. See also Partial vesting, later in this discussion.

The amount excludable is, generally, the least of your exclusion allowance, the limit on employer contributions, or the limit on elective deferrals. See Both elective deferrals and nonelective contributions, earlier.

Your rights are substantially vested when they are transferable or are not subject to a substantial risk of forfeiture.

Your rights are transferable if you can transfer any interest in any property to any person other than the transferor, but only if your rights in the property are not subject to a substantial risk of forfeiture.

Property is transferable if you can sell, assign, or pledge your interest in it to anyone other than the transferor and if you do not have to give up the property or its value if the substantial risk of forfeiture materializes. Property is not transferable merely because you may designate a beneficiary to receive it in the event of your death.

A substantial risk of forfeiture exists when your rights in property that are transferred are directly or indirectly conditioned upon future performance (or refraining from performance) of substantial services by any person. A substantial risk of forfeiture also exists when rights in property depend on the occurrence of a condition related to the purpose of the transfer and the possibility of forfeiture is substantial if the condition is not satisfied.

Taxability of rights that change from nonvested to vested. The amount includible in your gross income, when your rights change from nonvested to substantially vested, is the value of the annuity contract that, on the date of change, is:

1) From contributions made by your employer before the date of change, and
2) More than the amount excludable from gross income.

The value of an annuity contract on the date your rights become substantially vested means the cash surrender value of the contract on that date.

Partial vesting. If, during your tax year, only part of the beneficial interest in an annuity contract becomes substantially vested, only a portion of the annuity contract value on the date of the change is includible in your gross income for the tax year.

Figuering the amount includible.
The amount includible in your gross income is figured as follows:

1) Find the amount includible in gross income if, without regard to the exclusion allowance, the entire beneficial interest in the annuity contract had changed to a substantially vested interest during the tax year.
2) Multiply the amount in (1) by the percent of your beneficial interest that became substantially vested during the tax year.

The resulting amount in (2) is taxable to the extent it is more than the amount excludable from gross income.

Gift Tax
If, by choosing or not choosing an election or option, you provide an annuity for your beneficiary at or after your death, you may have made a taxable gift for gift tax purposes equal to the value of the annuity.

Joint and survivor annuity. If the gift is an interest in a joint and survivor annuity where only you and your spouse have the right to
receive payments, the gift will generally be treated as qualifying for the unlimited marital deduction.

More information. For information on the gift tax, see Publication 950, Introduction to Estate and Gift Taxes.

Distributions and Rollovers

Generally, a distribution cannot be made from a TSA contract until the employee:

• Attains age 59½,
• Separates from service,
• Dies, or
• Becomes disabled.

In most cases, the payments you receive, or that are made available to you, under your TSA contract are taxable in full as ordinary income. In general, the same tax rules apply to distributions from tax-sheltered annuities that apply to distributions from other retirement plans. These rules are explained in Publication 575, Pension and Annuity Income. Publication 575 also discusses the additional tax on early distributions from retirement plans.

Minimum Distributions

You must receive all, or at least a certain minimum, of your interest accruing after 1986 in the tax-sheltered annuity program by April 1 of the calendar year following the later of the calendar year in which you become age 70½ or the calendar year in which you retire. Check with your employer, plan administrator, or provider to find out whether this rule also applies to pre-1987 accruals. If not, a minimum amount of these accruals must begin to be distributed no later than the end of the calendar year in which you attain age 75. For each year thereafter, the minimum distribution must be made by the last day of the year. If you do not receive the required minimum distribution, you are subject to a nondeductible 50% excise tax.

For more information on minimum distribution requirements and the additional tax that applies if too little is distributed each year, see Publication 575.

No Special 5–or 10–Year Tax Option

A distribution from a tax-sheltered annuity does not qualify as a lump-sum distribution. This means you cannot use the special 5–or 10–year tax option.

Transfer of Interest in Tax-Sheltered Annuity

If you transfer all or part of your interest from a tax-sheltered annuity contract or account to another tax-sheltered annuity contract or account, the transfer is tax free. However, this treatment applies only if the transferred interest is subject to the same or stricter distribution restrictions. This rule applies regardless of whether you are a current employee, a former employee, or a beneficiary of a former employee. Transfers that do not satisfy this rule are plan distributions.

Tax-free transfers for certain cash distributions. A tax-free transfer may also apply to a cash distribution for your annuity contract or account from an insurance company that is subject to a rehabilitation, conservatorship, insolvency, or similar state proceeding. To receive tax-free treatment, you must do all of the following:

1) Reinvest the cash in an annuity contract or account issued by another insurance company.
2) Withdraw all the cash to which you are entitled in full settlement of your contract rights or the maximum permitted by the state.
3) Reinvest the cash distribution into another annuity contract or account issued by another insurance company or single custodial account not later than 60 days after you receive the cash distribution.
4) Assign all future distribution rights to the new contract or account for investment in that contract or account if you received an amount that is less than what you are entitled to because of state restrictions.
5) Reinvest in an annuity contract or account subject to the same or stricter distribution restrictions as the original contract.

In addition to the preceding requirements, you must provide the new insurer with a written statement containing the following information:

1) The gross amount of cash distributed under the old contract,
2) The amount of cash reinvested in the new contract, and
3) Your investment in the old contract on the date you receive your first cash distribution.

Also, you must attach the following items to your timely filed income tax return in the year you receive the first distribution of cash:

1) A copy of the statement you gave the new insurer.
2) A statement that includes:
   a) The words “ELECTION UNDER REV. PROC. 92-44,”
   b) The name of the company that issued the new contract, and
   c) The new policy number.

Tax-Free Rollovers

You can generally roll over tax free all or any part of a distribution from a tax-sheltered annuity (TSA) plan to an IRA or another TSA plan. The most you can roll over is the amount that, except for the rollover, would be taxable. The rollover must be completed by the 60th day following the day on which you receive the distribution.

Nonqualifying distributions. Under these rules, you cannot roll over:

1) Minimum distributions (generally required to begin at age 70½),
2) Substantially equal payments over your life or life expectancy,
3) Substantially equal payments over the joint lives or life expectancies of you and your beneficiary, or
4) Substantially equal payments for a period of 10 years or more.

Direct rollovers for TSA distributions. You have the option of having your TSA plan make the rollover directly to the IRA or new plan. Before you receive a distribution, your plan will give you information on this. It is generally to your advantage to choose this option because your plan will not withhold tax on the distribution if you choose it.

Withholding. If you receive a distribution that qualifies to be rolled over, the payer must withhold 20% of it for taxes (even if you plan to roll the distribution over). You can no longer choose to have no withholding unless you elect the direct rollover option.

Distribution received by you. If you receive a distribution that qualifies to be rolled over, you can roll over all or any part of the distribution. Generally, you will receive only 80% of the distribution because 20% must be withheld. If you roll over only the 80% you receive, you must pay tax on the 20% you did not roll over. You can replace the 20% that was withheld with other money within the 60-day period to make a 100% rollover.

Voluntary deductible contributions. For tax years 1982 through 1986, employees could make deductible contributions to a tax-sheltered annuity under the individual retirement arrangement (IRA) rules instead of deducting contributions to an IRA.

If you made voluntary deductible contributions to a tax-sheltered annuity under these IRA rules, the distribution of all or part of the accumulated deductible contributions may be rolled over assuming it otherwise qualifies as a distribution you can roll over. Accumulated deductible contributions are the deductible contributions plus income and gain allocable to the contributions, expenses allocable to the contributions, and losses allocable to the contributions, and minus distributions from the contributions, income, or gain.

Excess employer contributions. The portion of a distribution from a TSA transferred to an individual retirement account (IRA) that was previously included in income as excess employer contributions (discussed earlier) is not an eligible rollover distribution.

Its transfer does not affect the rollover treatment of the eligible portion of the transferred amounts. However, the ineligible portion is subject to the IRA contribution limits and may create an excess IRA contribution subject to a 6% excise tax (see chapter 7 of Publication 590).

Qualified Domestic Relations Order. You may be able to roll over tax free all or any part of an eligible rollover distribution from a TSA plan that you receive under a qualified domestic relations order (QDRO). If you receive the interest in the TSA as an employee’s spouse or former spouse under a QDRO, all of the rollover rules apply to you as if you were the employee. You can roll over your interest in the plan to an IRA or another TSA plan. For more information on the treatment of an interest received under a QDRO, see Publication 575.
Spouses of deceased employees. If you are the spouse of a deceased employee, you can roll over the qualifying distribution attributable to the employee. You can make the rollover only to an IRA, not to another TSA or qualified plan.

Second rollover. If you roll over a qualifying distribution to an IRA, you can, if certain conditions are satisfied, later roll the distribution into another TSA. For more information, see IRA as a holding account in Publication 590.

Frozen deposits. The 60-day period usually allowed for completing a rollover is extended for any time that the amount distributed is a frozen deposit in a financial institution. The 60-day period cannot end earlier than 10 days after the deposit ceases to be a frozen deposit.

A frozen deposit is any deposit that on any day during the 60-day period cannot be withdrawn because:
1) The financial institution is bankrupt or insolvent, or
2) The state where the institution is located has placed limits on withdrawals because one or more banks in the state are (or are about to be) bankrupt or insolvent.
How To Get More Information

You can get help from IRS in several ways.

Free publications and forms. To order free publications and forms, call 1–800–TAX–FORM (1–800–829–3676). You can also write to the IRS Forms Distribution Center nearest you. Check your income tax package for the address. Your local library or post office also may have the items you need.

For a list of free tax publications, order Publication 910, Guide to Free Tax Services. It also contains an index of tax topics and related publications and describes other free tax information services available from IRS, including tax education and assistance programs.

If you have access to TTY/TDD equipment, you can call 1–800–829–1040. If you have access to TTY/TDD equipment, you can call 1–800–829–4059 to ask tax questions or to order forms and publications. See your income tax package for details.

Tax questions. You can call the IRS with your tax questions. Check your income tax package or telephone book for the local number, or you can call 1–800–829–1040.

TTY/TDD equipment. If you have access to TTY/TDD equipment, you can call 1–800–829–4059 to ask tax questions or to order forms and publications. See your income tax package for hours of operation.

Evaluating the quality of our telephone services. To ensure that IRS representatives give accurate, courteous, and professional answers, we evaluate the quality of our “800 number” telephone services in several ways.

- A second IRS representative sometimes monitors live telephone calls. That person only evaluates the IRS assistor and does not keep a record of any taxpayer’s name or tax identification number.
- We sometimes record telephone calls to evaluate IRS assistants objectively. We hold these recordings no longer than one week and use them only to measure the quality of assistance.
- We value our customers’ opinions. Throughout this year, we will be surveying our customers for their opinions on our service.

How to use worksheets. Since the smallest of the limits that apply to you is your limit for the year, first determine the amounts of these limits by completing the worksheets for the limits.

Worksheets to complete. You need to complete no more than four worksheets. You must complete Worksheet 1 and Worksheet 2. If elective deferrals were contributed to your TSA, also complete Worksheet 3. If you choose an alternative limit because you can make a catch-up election, complete Worksheet 4, 5, or 6, whichever one applies to the alternative limit you choose. Each worksheet includes steps for figuring the amount of contributions you can exclude from your income and any contributions you must include in income.

Worksheets

Contributions to your TSA are subject to various limits. Contributions that are more than the limits are excess contributions or excess deferrals that must be included in your income and can result in additional taxes. See Treatment of excess contributions, under Exclusion Limits, earlier.

You can use the following worksheets to figure the amount that can be contributed to your TSA without penalty and can be excluded from your income for the year.

Limits. There are three limits that apply to contributions to your TSA. Contributions for a year must be tested by each of the limits to determine the amount that your employer can contribute and you can exclude from your income for that year. See Exclusion Limits, earlier.

Elective deferrals only. If employer contributions for the year are only elective deferrals, as defined earlier under Contributions, the amount that can be contributed and excluded from your income for the year is the smallest of the following limits:

1) Exclusion allowance (Worksheet 1)
2) Limit on employer contributions (Worksheet 2)
3) Limit on elective deferrals (Worksheet 3)

Elective deferrals for a year cannot be more than $9,500 unless the exception for 15–year employees applies (see Step 2 of Worksheet 3). If the exception applies, your elective deferrals cannot be more than $12,500.

Elective deferrals and other contributions. If employer contributions for the year include matching contributions and/or nonelective contributions in addition to elective deferrals, the total that can be contributed and deferred (excluded from your income for the year) can be more than the limit on elective deferrals.

Figuring the limit. To figure the limit on the amount (including elective deferrals) that can be contributed and deferred for a year, complete the following worksheets:

1) Worksheet 1 (the exclusion allowance)
2) Worksheet 2, Step 1 (the limit on employer contributions).

Your overall limit on employer contributions that can be deferred (excluded form your income) is the smaller of line 6, Worksheet 1, or line 3, Worksheet 2, unless you can use one of the alternative limits.

Alternative limits. You may be able to use an alternative limit instead of the limit in 1) or 2) of the preceding list. The limit in 1) can be replaced with the limit in 2) by electing the Overall Limit (Worksheet 6). The limit in 2) can be figured in a different way by electing the Year of Separation from Service Limit (Worksheet 4) or the Any Year Limit (Worksheet 5). To make any of these elections, you must meet the requirements described under Catch-up Election — Alternative Limits for Certain Employees, earlier.
### Worksheet 1—Computation of Exclusion Allowance

<table>
<thead>
<tr>
<th>Step 1—Exclusion Allowance</th>
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<tbody>
<tr>
<td>1) Includible compensation</td>
<td>$</td>
</tr>
<tr>
<td>2) Percentage limit</td>
<td>20%</td>
</tr>
<tr>
<td>3) Years of service</td>
<td></td>
</tr>
<tr>
<td>4) Multiply (1) ( \times ) (2) ( \times ) (3)</td>
<td>$</td>
</tr>
<tr>
<td>5) Minus: Amounts previously excludable</td>
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<tr>
<td>6) Exclusion allowance</td>
<td>$</td>
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</tbody>
</table>

### Step 1—Limit on Employer Contributions

<table>
<thead>
<tr>
<th>Step 1—Limit on Employer Contributions</th>
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</thead>
<tbody>
<tr>
<td>1) Maximum ($30,000) [See Limit on Employer Contributions.]</td>
<td>$</td>
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<tr>
<td>2) 25% of compensation</td>
<td></td>
</tr>
<tr>
<td>3) Limit on employer contributions [lesser of (1) or (2)]</td>
<td>$</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Step 2—Contributions in Excess of Employer Limit</th>
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<tbody>
<tr>
<td>4) Current year contribution by employer (excluding cost of life insurance)*</td>
<td>$</td>
</tr>
<tr>
<td>5) Minus: Limit on employer contributions (line 3)</td>
<td></td>
</tr>
<tr>
<td>6) Excess (if any)</td>
<td>$</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Step 3—Amount Excludable from Gross Income</th>
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</thead>
<tbody>
<tr>
<td>7) a) Employer contribution (line 4)</td>
<td>$</td>
</tr>
<tr>
<td>b) Limit on employer contributions (line 3)</td>
<td>$</td>
</tr>
<tr>
<td>c) Exclusion allowance (Worksheet 1, line 6)</td>
<td>$</td>
</tr>
<tr>
<td>d) Limit on elective deferrals (Worksheet 3, line 16)</td>
<td>$</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Step 4—Amount Includable in Gross Income</th>
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</thead>
<tbody>
<tr>
<td>9) Employer contribution (line 4)</td>
<td>$</td>
</tr>
<tr>
<td>10) Minus: Amount excludable (line 8)</td>
<td></td>
</tr>
<tr>
<td>11) Amount includible in gross income</td>
<td>$</td>
</tr>
</tbody>
</table>

*The cost of life insurance is includible in gross income.

Page 17
### Worksheet 3—Limit on Elective Deferrals

#### Step 1—Total Elective Deferrals
1) Elective contributions to tax-sheltered annuities under a salary reduction agreement $ 
2) Elective contributions under cash or deferred arrangements (section 401(k) plans) and section 501(c)(18) plans 
3) Elective contributions to salary reduction simplified employee pension (SEP) plans and to SIMPLE plans 
4) Total elective deferrals for year (add lines (1), (2), and (3)) $ 

#### Step 2—Increase in Limit for Long Service

**Note:** Skip this step if you do not have at least 15 years service with a qualifying organization (see Increase for 15-year employees under Limit on Elective Deferrals)

5) Number of years service with the qualifying organization 
6) Multiply $5,000 by the number of years in (5) $ 
7) Total elective deferrals for prior years made for you by the qualifying organization 
8) Subtract line (7) from line (6) $ 
9) Enter all increases in the limit for long service (as figured in this Step 2) for prior years $ 
10) Subtract line (9) from $15,000 $ 
11) Enter the smaller of line (8) or line (10), but not more than $3,000 $ 

#### Step 3—Limit on Elective Deferrals
12) Enter $9,500 plus the amount from line (11) $ 
13) Basic allowable amount (enter $9,500 for 1997) 
14) Subtract line (13) from line (12) $ 
15) Enter the smaller of line (1) or line (14) 
16) Add lines (13) and (15). This is your limit on elective deferrals for the year $ 
17) Excess elective deferrals—Subtract line (16) from line (4). Do not enter less than zero. Include this amount in your income for the year the excess deferrals were made (see Excess Deferrals under Limit on Elective Deferrals) $
### Worksheet 4—Year of Separation from Service Limit Election

#### Step 1—Limit on Employer Contributions
1) Maximum [See Limit on Employer Contributions.]
   $30,000

2) Exclusion allowance (modified)
   - a) Includible compensation $____________
   - b) Percentage limit 20%
   - c) Years of service (limited to 10 years) $____________
   - d) Multiply (a) $ (b) × (c) $____________
   - e) Minus: Amount previously excludable during 10 years (including prior year excess contributions) $____________
   - f) Exclusion allowance (modified) $____________

3) Limit on employer contributions [lesser of (1) or (2)(f)] $____________

#### Step 2—Contributions in Excess of Employer Limit
4) Current year contribution by employer (excluding cost of life insurance) $____________

5) Minus: Limit on employer contributions (line 3) $____________

6) Excess (if any) $____________

#### Step 3—Amount Excludable from Gross Income
7) a) Employer contribution (line 4) $____________
   - b) Limit on employer contributions (line 3) $____________
   - c) Exclusion allowance (Worksheet 1, line 6) $____________
   - d) Limit on elective deferrals (Worksheet 3, line 16) $____________

8) Amount excludable from gross income [least of (a), (b), (c), or (d)] $____________

#### Step 4—Amount Includable in Gross Income
9) Employer contribution $____________

10) Minus: Amount excludable (line 8) $____________

11) Amount includible in gross income $____________

---

1 Election applies only to employees of certain organizations. See Catch-up Election—Alternative Limits for Certain Employees.

2 The cost of life insurance is includible in gross income.
**Worksheet 5—Any Year Limit Election**

<table>
<thead>
<tr>
<th>Step 1—Limit on Employer Contributions</th>
<th>Step 2—Contributions in Excess of Employer Limit</th>
</tr>
</thead>
<tbody>
<tr>
<td>1) $4,000 plus 25% of includible compensation</td>
<td>5) Current year contribution by employer (excluding cost of life insurance)²</td>
</tr>
<tr>
<td>2) Exclusion allowance</td>
<td>$</td>
</tr>
<tr>
<td>a) Includible compensation</td>
<td>$</td>
</tr>
<tr>
<td>b) Percentage limit</td>
<td>20%</td>
</tr>
<tr>
<td>c) Years of service</td>
<td>$</td>
</tr>
<tr>
<td>d) (a) × (b) × (c)</td>
<td>$</td>
</tr>
<tr>
<td>e) Minus: Amounts previously excludable (including prior year excess contributions)</td>
<td>$</td>
</tr>
<tr>
<td>f) Exclusion allowance</td>
<td>$</td>
</tr>
<tr>
<td>3) Maximum</td>
<td>$15,000</td>
</tr>
<tr>
<td>4) Limit on employer contributions [least of (1), (2)(f), or (3)]</td>
<td>$</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Step 3—Amount Excludable from Gross Income</th>
<th>Step 4—Amount Includable in Gross Income</th>
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</thead>
<tbody>
<tr>
<td>8) a) Employer contribution (line 5)</td>
<td>10) Employer contribution (line 5)</td>
</tr>
<tr>
<td>b) Limit on employer contributions (line 4)</td>
<td>11) Minus: Amount excludable (line 9)</td>
</tr>
<tr>
<td>c) Exclusion allowance (Worksheet 1, line 6)</td>
<td>12) Amount includible in gross income</td>
</tr>
<tr>
<td>d) Limit on elective deferrals (Worksheet 3, line 16)</td>
<td>$</td>
</tr>
<tr>
<td>9) Amount excludable from gross income (least of (a), (b), (c), or (d)]</td>
<td>$</td>
</tr>
</tbody>
</table>

| 1) Employer contribution (line 5) | $ |
| Limit on employer contributions (line 4) | $ |
| Exclusion allowance (Worksheet 1, line 6) | $ |
| Limit on elective deferrals (Worksheet 3, line 16) | $ |
| Amount excludable from gross income (least of (a), (b), (c), or (d)] | $ |

| 10) Employer contribution (line 5) | $ |
| Minus: Amount excludable (line 9) | $ |
| Amount includible in gross income | $ |

¹Election applies only to employees of certain organizations. See Catch-up Election—Alternative Limits for Certain Employees.
²The cost of life insurance is includible in gross income.
### Worksheet 6—Overall Limit Election

<table>
<thead>
<tr>
<th>Step 1— Limit on Employer Contributions</th>
<th>Step 4— Amount Includable in Gross Income</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1) Maximum [See Limit on Employer Contributions]</strong></td>
<td><strong>9) Employer contribution (line 4)</strong> $</td>
</tr>
<tr>
<td><strong>2) 25% \times compensation [See Compensation, earlier, under Limit on Employer Contributions]</strong></td>
<td><strong>10) Minus: Amount excludable (line 8)</strong> $</td>
</tr>
<tr>
<td><strong>3) Limit on employer contributions [lesser of (1) or (2)]</strong></td>
<td><strong>11) Amount includable in gross income</strong> $</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Step 2— Contributions in Excess of Employer Limitation</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>4) Current year contributions by employer (excluding cost of life insurance)</strong> $</td>
</tr>
<tr>
<td><strong>5) Minus: Limit on employer contributions (line 3)</strong> $</td>
</tr>
<tr>
<td><strong>6) Excess (if any)</strong> $</td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Step 3— Amount Excludable from Gross Income</th>
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</thead>
<tbody>
<tr>
<td><strong>7) a) Employer contribution (line 4)</strong> $</td>
</tr>
<tr>
<td><strong>b) Limit on employer contributions (line 3)</strong> $</td>
</tr>
<tr>
<td><strong>c) Limit on elective deferrals, (Worksheet 3, line 16)</strong> $</td>
</tr>
<tr>
<td><strong>8) Amount excludable from gross income [least of (a), (b), or (c)]</strong> $</td>
</tr>
</tbody>
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---

1. Election applies only to employees of certain organizations. See Catch-up Election—Alternative Limits for Certain Employees.
2. Limit on employer contributions is substituted for the exclusion allowance.
3. The cost of life insurance is includible in gross income.
4. If you participate in other qualified plans of your employer besides your TSA, contributions to those accounts must be included here.
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<td>Part-time for a full year</td>
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<td>Part-time or full-time for part of a year</td>
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<td>Years of service</td>
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Tax Publications for Individual Taxpayers

General Guides
1 Your Rights as a Taxpayer
17 Your Federal Income Tax (For Individuals)
225 Farmer's Tax Guide
509 Tax Calendars for 1998
553 Highlights of 1997 Tax Changes
595 Tax Highlights for Commercial Fishermen
910 Guide to Free Tax Services

Specialized Publications
3 Armed Forces' Tax Guide
378 Fuel Tax Credits and Refunds
463 Travel, Entertainment, Gift, and Car Expenses
501 Exemptions, Standard Deduction, and Filing Information
502 Medical and Dental Expenses
503 Child and Dependent Care Expenses
504 Divorced or Separated Individuals
505 Tax Withholding and Estimated Tax
508 Educational Expenses
514 Foreign Tax Credit for Individuals
516 U.S. Government Civilian Employees Stationed Abroad
517 Social Security and Other Information for Members of the Clergy and Religious Workers
519 U.S. Tax Guide for Aliens
520 Scholarships and Fellowships
521 Moving Expenses
523 Selling Your Home
524 Credit for the Elderly or the Disabled
525 Taxable and Nontaxable Income
526 Charitable Contributions
527 Residential Rental Property
529 Miscellaneous Deductions

Commonly Used Tax Forms
1040 U.S. Individual Income Tax Return
Sch A Itemized Deductions
Sch B Interest and Dividend Income
Sch C Profit or Loss From Business
Sch C-EZ Net Profit From Business
Sch D Capital Gains and Losses
Sch E Supplemental Income and Loss
Sch EIC Earned Income Credit
Sch F Profit or Loss From Farming
Sch H Household Employment Taxes
Sch R Credit for the Elderly or the Disabled
Sch SE Self-Employment Tax
1040EZ U.S. Individual Income Tax Return
Sch 1 Interest and Dividend Income for Form 1040A Filers
Sch 2 Child and Dependent Care Expenses for Form 1040A Filers
Sch 3 Credit for the Elderly or the Disabled for Form 1040A Filers
1040-ES Estimated Tax for Individuals
1040X Amended U.S. Individual Income Tax Return
2106 Employee Business Expenses
2106-EZ Unreimbursed Employee Business Expenses
2119 Sale of Your Home
2210 Underpayment of Estimated Tax by Individuals, Estates and Trusts
2441 Child and Dependent Care Expenses
2848 Power of Attorney and Declaration of Representative
3903 Moving Expenses
4562 Depreciation and Amortization

Spanish Language Publications
15P Derechos del Contribuyente
579SP Cómo Preparar la Declaración de Impuesto Federal
594SP Comprendiendo el Proceso de Cobro
596SP Crédito por Ingreso del Trabajo
850SP English-Spanish Glossary of Words and Phrases Used in Publications Issued by the Internal Revenue Service
1544SP Informe de Pagos en Efectivo en Exceso de $10,000 (Recibidos en una Ocupación o Negocio)

4868 Application for Automatic Extension of Time To File U.S. Individual Income Tax Return
4952 Investment Interest Expense Deduction
5329 Additional Taxes Attributable to Qualified Retirement Plans (Including IRAs), Annuities, and Modified Endowment Contracts
6251 Alternative Minimum Tax—Individuals
8283 Noncash Charitable Contributions
8582 Passive Activity Loss Limitations
8606 Nondeductible IRAs (Contributions, Distributions, and Basis)
8822 Change of Address
8829 Expenses for Business Use of Your Home