

# Revenue Ruling 81-275

## Qualifying rollover distribution

Advice has been requested as to whether a distribution of a life insurance contract and cash from an employees' retirement plan qualified under section 401(a) of the Internal Revenue Code can be rolled over into an individual retirement account (IRA) described in section 408(a).

An employee was a participant in the only qualified retirement plan maintained by the employer. The related trust, which is exempt under section 501(a) of the Code, is partially funded through the purchase of individual life insurance contracts.

The employee separated from the service of the employer in 1979 and received a distribution of the employee's entire interest under the plan within one taxable year. The distribution included cash and a life insurance contract. The employee did not surrender, convert or sell the insurance contract.

Section 402(a)(1) of the Code provides that, generally, amounts distributed to any distributee by any employees' trust described in section 401(a), which is exempt under section 501(a), shall be taxable to the distributee in the year in which so distributed under section 72 (relating to annuities).

An exception to this rule is provided under section 402(a)(5) of the Code if the balance to the credit of an employee in a qualified trust is paid to the employee in a qualifying rollover distribution (such as a lump sum distribution) and the employee transfers any portion of the property received within 60 days of such distribution to an IRA. Other than money or the proceeds from a bona fide sale of property received in a qualifying rollover distribution, the amount transferred must consist of the property distributed.

Under the exception, amounts distributed and transferred into an IRA are not includible in the employee's gross income on account of being distributed from the plan.

A "lump sum distribution" is defined in section 402(e)(4)(A) of the Code as a distribution or payment from a qualified employees' trust described in section 401(a) and exempt under section 501(a), within one taxable year of the employee, of the balance to the credit of an employee which becomes payable, among other reasons, on account of the employee's separation from the service.

Section 408(a)(3) of the Code states that no part of an IRA's trust funds may be invested in life insurance contracts.

In this case, the distribution to the employee of the insurance contract and cash is a lump sum distribution under section 402(a)(4)(A) because it represents the employee's entire interest in the qualified retirement plan and it was distributed within one taxable year on account of separation from service with the employer.

Because this was a lump sum distribution, the employee may transfer the portion of the qualifying rollover distribution consisting of cash to the IRA within 60 days after receipt under the tax-free rollover provisions of section 402(a)(5) of the Code. While a distribution of property other than money may be rolled over into an IRA, a contribution to an IRA may not include the

transfer of a retirement income, endowment or other life insurance contract because section 408(a)(3) specifically precludes investment of IRA funds in life insurance contracts.

Accordingly, the employee in this case may transfer into an IRA the cash portion of the qualifying rollover distribution, after deducting employee contributions, and exclude those amounts from gross income in the year received. However, the employee may not transfer the life insurance contract into an IRA. Therefore, the value of the life insurance contract, except for amounts which are considered as having been contributed by the employee, is taxable in accordance with the rules of section 402 of the Code.

However, notwithstanding the above conclusion, a rollover of the life insurance contract may be effected if it is made to an eligible retirement plan as defined in section 402(a)(5)(D)(iv), such as a trust qualified under section 401, that does not otherwise preclude investments in life insurance contracts.

This ruling does not deal with the employee's option to surrender or sell the insurance contract and rollover the proceeds into an IRA. For those rules see section 402(a)(6)(D) of the Code.