The entire $1,000 is to be excluded from the gross income of the Y Corporation.

Example (3). The facts are the same as in example (2) except that, prior to the death of A, the Y Corporation transfers the policy to the Z Corporation for $600. The Z Corporation receives the proceeds of $1,000 upon the death of A. The amount which the Z Corporation can exclude from its gross income is limited to $600 plus any premiums paid by the Z Corporation subsequent to the transfer of the policy to it.

Example (4). The facts are the same as in example (3) except that, prior to the death of A, the Z Corporation transfers the policy to the M Corporation in a tax-free reorganization (the policy having a basis for determining gain or loss in the hands of the M Corporation determined by reference to its basis in the hands of the Z Corporation). The M Corporation receives the proceeds of $1,000 upon the death of A. The amount which the M Corporation can exclude from its gross income is limited to $600 plus any premiums paid by the Z Corporation and the M Corporation subsequent to the transfer of the policy to the Z Corporation.

Example (5). The facts are the same as in example (3) except that, prior to the death of A, the Z Corporation transfers the policy to the N Corporation, in which A is a shareholder. The N Corporation receives the proceeds of $1,000 upon the death of A. The entire $1,000 is to be excluded from the gross income of the N Corporation.

Example (6). A pays premiums of $500 for an insurance policy in the face amount of $1,000 upon his own life, and subsequently transfers the policy to his wife B for $600. B later transfers the policy without consideration to C, who is the son of A and B. C receives the proceeds of $1,000 upon the death of A. The amount which C can exclude from his gross income is limited to $600 plus any premiums paid by B and C subsequent to the transfer of the policy to B.

Example (7). The facts are the same as in example (6) except that, prior to the death of A, C transfers the policy without consideration to A, the insured. A's estate receives the proceeds of $1,000 upon the death of A. The entire $1,000 is to be excluded from the gross income of A's estate.

[T.D. 6500, 25 FR 11402, Nov. 26, 1960, as amended by T.D. 6783, 29 FR 18356, Dec. 24, 1964; T.D. 7836, 47 FR 42337, Sept. 27, 1982]

§ 1.101–2 Employees' death benefits.

(a) *In general.* (1) Section 101(b) states the general rule that amounts up to $5,000 which are paid to the beneficiaries or the estate of an employee, or former employee, by or on behalf of an employer and by reason of the death of the employee shall be excluded from the gross income of the recipient. This exclusion from gross income applies whether payment is made to the estate of the employee or to any beneficiary (individual, corporation, or partnership), whether it is made directly or in trust, and whether or not it is made pursuant to a contractual obligation of the employer. The exclusion applies whether payment is made in a single sum or otherwise, subject to the provisions of section 101 (c), relating to amounts held under an agreement to pay interest thereon (see § 1.101–3). The exclusion from gross income also applies to any amount not actually paid which is otherwise taxable to a beneficiary of an employee because it was made available as a distribution from an employee's trust.

(2) The exclusion does not apply to amounts constituting income payable to the employee during his life as compensation for his services, such as bonuses or payments for unused leave or uncollected salary, nor to certain other amounts with respect to which the deceased employee possessed, immediately before his death, a nonforfeitable right to receive the amounts while living (see section 101(b)(2)(B) and paragraph (d) of this section). Further, the exclusion does not apply to amounts received as an annuity under a joint and survivor annuity obligation where the employee was the primary annuitant and the annuity starting date occurred before the death of the employee (see section 101 (b)(2)(C) and paragraph (e)(1)(ii) of this section). In the case of amounts received by a beneficiary as an annuity (but not as a survivor under a joint and survivor annuity with respect to which the employee was the primary annuitant), the exclusion is applied indirectly by means of the provisions of section 72 and the regulations thereunder (see section 101(b)(2)(D) and paragraph (e)(1) (iii) and (iv) of this section). Thus, for example, the exclusion applies to amounts which are received by a survivor of an employee retired on disability under the provisions of the Civil Service retirement law (5 U.S.C. 8301 or any former corresponding provisions of law) or the Retired Serviceman's Family Protection Plan or Survivor Benefit Plan (10 U.S.C. 1431 *et seq.*), provided

such employee dies before attaining mandatory retirement age (as defined in § 1.105–4 (a)(3)(i)(B)).

(3) The total amount excludable with respect to any employee may not exceed $5,000, regardless of the number of employers or the number of beneficiaries. For allocation of the exclusion among beneficiaries, see paragraph (c) of this section. For rules governing the taxability of benefits payable on the death of an employee under pension, profitsharing, or stock bonus plans described in section 401(a) and exempt under section 501(a), under annuity plans described in section 403(a), or under annuity contracts to which paragraph (a) or (b) of § 1.403(b)–1 applies, see sections 72(m)(3), 402(a), and 403 and the regulations thereunder.

(b) *Payments under certain employee benefit plans*—(1) *In general.* Where a payment is made by reason of the death of an employee by an employer-provided welfare fund or a trust, including a stock bonus, pension, or profitsharing trust described in section 401 (a), or by an insurance company (if such payment does not constitute ''life insurance'' within the purview of section 101(a), the payment shall be considered to have been made by or on behalf of the employer to the extent that it exceeds amounts contributed by, or deemed contributed by, the deceased employee.

(2) *Cross references.* For provisions governing the taxability of distributions payable on the death of an employee participant—

(i) Under a trust described in section 401(a) and exempt from tax under section 501(a), see paragraph (c) of § 1.72–16 and paragraph (a)(5) of § 1.402 (a)–1;

(ii) Under an annuity plan described in section 403(a), see paragraph (c) of § 1.72–16 and paragraph (c) of § 1.403 (a)–1;

(iii) Under annuity contracts to which paragraph (a) or (b) of § 1.403 (b)–1 applies, see paragraph (c) (2) and (3) of § 1.403(b)–1;

(iv) Under eligible State deferred compensation plans described in section 457 (b), see paragraph (c) of § 1.457–1.

(c) *Allocation of the exclusion.* (1) Where the aggregate payments by or on behalf of an employer or employers as death benefits to the beneficiaries or the estate of a deceased employee exceed $5,000, the $5,000 exclusion shall be apportioned among them in the same proportion as the amount received by or the present value of the amount payable to each bears to the total death benefits paid or payable by or on behalf of the employer or employers.

(2) The application of the rule in subparagraph (1) of this paragraph may be illustrated by the following example:

Example. The M Corporation, the employer of A, a deceased employee who died November 30, 1954, makes payments in 1955 to the beneficiaries of A as follows: $5,000 to W, A's widow, $2,000 to B, the son of A, and $3,000 to C, the daughter of A. No other amounts are paid by any other employer of A to his estate or beneficiaries. By application of the apportionment rule stated above, W, the widow, will exclude $2,500 ($5,000/$10,000, or one-half, of $5,000); B, the son, will exclude $1,000 ($2,000/$10,000, or one-fifth, of $5,000); and C, the daughter, will exclude $1,500 ($3,000/$10,000, or three-tenths, of $5,000).

(d) *Nonforfeitable rights.* (1) Except as provided in subparagraphs (3) and (4) of this paragraph, the exclusion provided by section 101(b) does not apply to amounts with respect to which the deceased employee possessed, immediately before his death, a nonforfeitable right to receive the amounts while living. Section 101(b)(2)(B). For the purpose of section 101(b) and this paragraph, an employee shall be considered to have had a nonforfeitable right with respect to—

(i) Any amount to which he would have been entitled—

(a) If he had made an appropriate election or demand, or

(b) Upon termination of his employment (see examples (5) and (6) of subparagraph (2) of this paragraph); or

(ii) The present value (immediately before his death) of—

(a) Amounts payable as an annuity (as defined in paragraph (b) of § 1.72–2, whether immediate or deferred) by or on behalf of the employer (see example (1) of subparagraph (2) of this paragraph), or

(b) Amounts which would have been so payable if the employee had terminated his employment and continued to live;

or

(iii) Any amount to the extent it is paid in lieu of amounts described in either subdivision (i) or (ii) of this subparagraph. See examples (2), (3), and (4) of subparagraph (2) of this paragraph.

For purposes of subdivision (iii) of this subparagraph, any amount paid in discharge of an obligation which arose solely because of the existence of a particular fact or circumstance subsequent to the employee's death shall not be considered an amount paid in lieu of amounts described in subdivision (i) or (ii) of this subparagraph. Subdivision (iii) of this subparagraph shall apply, however, to the extent indicated therein, to amounts payable without regard to any such contingency (to the extent that such amounts are equal to or less than those described in subdivision (i) and (ii) of this subparagraph which are not paid). See paragraph (e)(1)(iii)*(b)* of this section for rules with respect to finding the present value of an annuity immediately before the employee's death.

(2) The application of paragraph (d)(1) of this section may be illustrated by the following examples, in which it is assumed that the plans are not ''qualified plans'' and that no employer is an organization referred to in section 170(b)(1)(A) (ii) or (vi) or a religious organization (other than a trust) which is exempt from tax under section 501(a):

Example (1). A, who was a participant under the X Company pension plan, retired on December 31, 1953. He had made no contributions to the plan. Upon his retirement, he became entitled to monthly payments of $100 payable for life, or 120 months certain. A died on October 31, 1954, having received 10 monthly payments of $100 each. After his death, the monthly payments became payable to his estate for the remaining 110 months certain. No exclusion from gross income is allowed to A's estate (or any beneficiary who receives the right to such payments from the estate), since the employee's right to the monthly payments was nonforfeitable at the date of his death. It will be noted that in this example it is unnecessary to consider the present value of the annuity to A just before his death since the payments to be made include only those certain to be made in any event under the plan whether or not A continued to live.

Example (2). C, a participant under the Y Company pension plan, died on December 15, 1954, while actively in the employment of the company, survived by a widow and minor children. Because of his years of service, he would have been entitled to an annuity for life, his own contributions to the plan and interest thereon being guaranteed, if he had retired or terminated his employment at a time immediately before his death. The plan further provides that—(a) if, but only if, an employee is survived by a widow and minor children, his widow is to receive an annuity for her life without regard to whether or not the employee had begun his annuity; (b) any payments made with respect to his widow's annuity are to reduce the guaranteed amount to an equal extent; and (c) if the employee is not so survived, the guaranteed amount is payable to his beneficiary or estate, but no amount is payable to anyone with respect to what would have been the widow's annuity. In view of these provisions, that portion of the present value of the annuity payable to C's widow which exceeds the guaranteed amount shall be considered paid neither as an amount, nor in lieu of an amount, which C had a nonforfeitable right to receive while living. The reason for this result is that the payment of such excess is contingent upon C's being survived by a widow and minor children, a circumstance existing subsequent to his death. Conversely, to the extent that the present value of the annuity payable to C's widow does not exceed the guaranteed amount, annuity payments attributable to such present value shall be considered paid in lieu of an amount which C had a nonforfeitable right to receive while living.

Example (3). D, a participant under the Y Company pension plan, died on January 1, 1955, while actively in the employment of the company. The Y Company plan provides that where an employee dies in service, the present value of the accumulated credits which he could have obtained at that time if he had instead separated from the service shall be paid in a single sum to his surviving spouse or to his estate if no widow survives him. The present value of D's accumulated credits, at the time of his death, was $10,000. However, the plan also provides that a surviving spouse may elect to take, in lieu of a single sum, an annuity the present value of which exceeds such sum by $2,500. D's widow elects to receive an annuity (the present value of which is $12,500). Therefore, $2,500 is an amount to which the exclusion of section 101(b) and this section shall apply.

Example (4). A, an employee of the X Company, continues to work after reaching the normal retirement age of 60 years, although he could have retired at that age and obtained an annuity of $3,000 per year for his life. A is not entitled to any part of the annuity while he is employed and receiving compensation. A dies at the age of 67 while still in active employment. Since he had passed normal retirement age, his additional years of service did not entitle him to a larger annuity at age 67 than that which he could have obtained at age 60. However, the plan of the X Company provides that in the event of an employee's death prior to separation from the service, his widow is to be paid an annuity for her life in the same amount per year as that which the employee could have obtained if he had instead retired; but if no widow survives him, the present value of the annuity which the employee could have obtained at a time just before his death is to be paid to a named beneficiary or the estate of the employee. Assuming that the present value of the annuity to A's widow, whose age is 61, is $36,000 and the present value of the annuity which would have been payable to A at age 67 if he had then retired is $23,500, the present value of the widow's annuity, to the extent of $23,500, is an amount which is payable in lieu of amounts which the employee had a nonforfeitable right to receive while living because it does not exceed the value of his nonforfeitable rights and is not otherwise paid. On the other hand, the $12,500 excess of the value of the widow's annuity ($36,000) over the value of the employee's annuity ($23,500) is an amount to which section 101(b) applies since the employee had no right to any part of it. If no other death benefits are payable, a $5,000 exclusion is available (see section 101(b)(2)(D) and paragraph (e) of this section).

Example (5). The trustee of the X Corporation noncontributory profit-sharing plan is required under the provisions of the plan to pay to the beneficiary of B, an employee of the X Corporation who died on July 1, 1955, the benefit due on account of the death of B. The provisions of the profit-sharing plan give each participating employee in case of termination of employment a 10-percent vested interest in the amount accumulated in his account for each year of participation in the plan. In case of death, the entire credit in the participant's account is to be paid to his beneficiary. At the time of B's death, he had been a participant for three years and the accumulation in his account was $8,000. After his death this amount is paid to his beneficiary. At the time of B's death, the amount distributable to him on account of termination of employment would have been $2,400 (30 percent of $8,000). The difference of $5,600 ($8,000 minus $2,400), payable to the beneficiary of B, is an amount payable solely by reason of B's death. Accordingly, $5,000 of the $5,600 may be excluded from the gross income of the beneficiary receiving such payment (assuming no other death benefits are involved). However, if it is assumed that the facts are the same as above, except that at the time of his death B has been a participant for 6 years, the amount distributable to him on account of termination of employment would have been $4,800 (60 percent of $8,000). The difference of $3,200 ($8,000 minus $4,800), payable to B's beneficiary, is an amount payable solely by reason of B's death. Accordingly, only $3,200 may be excluded from the gross income of the beneficiary receiving such payment (assuming no other death benefits are involved).

Example (6). The X Corporation instituted a trust, forming part of a pension plan, for its employees, the cost thereof being borne entirely by the corporation. The plan provides, in part, that after 10 or more years of service and attaining the age of 55, an employee can elect to retire and receive benefits before the normal retirement date contingent upon the employer's approval. If he retires without the employer's consent, or voluntarily leaves the company, no benefits are or will be payable. The plan further provides that if the employee is involuntarily separated or dies before retirement, he or his beneficiary, respectively, will receive a percentage of the reserve provided for the employee in the trust fund on the following basis: 10 to 15 years of service, 25 percent; 15 to 20 years of service, 50 percent; 20 to 25 years of service, 75 percent; 25 or more years of service, 100 percent. A, an employee of the X Corporation for 17 years, died at the age of 56 while in the employ of the corporation. At the time of his death, $15,000 was the reserve provided for him in the trust. His beneficiary receives $7,500, an amount equal to 50 percent of the reserve provided for A's retirement; accordingly, $5,000 of the $7,500 may be excluded from the gross income of the beneficiary receiving such payment (assuming no other death benefits are involved) since A, prior to his death, had only a forfeitable right to receive $7,500.

(3)(i) Notwithstanding the rule stated in subparagraph (1) of this paragraph and illustrated in subparagraph (2) of this paragraph, the exclusion from gross income provided by section 101(b) applies to the receipt of certain amounts, paid under ''qualified'' plans, with respect to which the deceased employee possessed, immediately before his death, a nonforfeitable right to receive the amounts while living (see section 101(b)(2)(B) (i) and (ii)). The payments to which this exclusion applies are—

(a) ''Total distributions payable'' by a stock bonus, pension, or profit-sharing trust described in section 401(a) which is exempt from tax under section 501(a), and

(b) ''Total amounts'' paid under an annuity contract under a plan described in section 403(a), provided such distributions or amounts are paid in

full within one taxable year of the distributee (see example (3) of subdivision (ii) of this subparagraph). For the purposes of applying section 101(b), ''Total distributions payable'' means the balance to the credit of an employee which becomes payable to a distributee on account of the employee's death, either before or after separation from the service (see section 402(a)(3)(C), the regulations thereunder, and examples (2) and (4) of subdivision (ii) of this subparagraph); and ''total amounts'' means the balance to the credit of an employee which becomes payable to the payee by reason of the employee's death, either before or after separation from the service (see section 403(a)(2)(B), the regulations thereunder, and example (1) of subdivision (ii) of this subparagraph). See subparagraph (4) of this paragraph relating to the exclusion of amounts which are received under annuity contracts purchased by certain exempt organizations and with respect to which the deceased employee possessed, immediately before his death, a nonforfeitable right to receive the amounts while living.

(ii) The application of the provisions of subdivision (i) of this subparagraph may be illustrated by the following examples:

Example (1). The widow of an employee elects, under a noncontributory ''qualified'' plan, to receive in a lump sum the present value of the annuity which C, the deceased employee, could have obtained at a time just before his death if he had retired at that time. Such present value is $6,000. Of this amount, $5,000 is excludable from the widow's gross income despite the fact that C had a nonforfeitable right to the amount in lieu of which the payment is made, since such payment is an amount to which subdivision (i) of this subparagraph applies (assuming no other death benefits are involved).

Example (2). The trustee of the X Corporation noncontributory, ''qualified'', profit-sharing plan is required under the provisions of the plan to pay to the beneficiary of B, an employee of the X Corporation who died on July 1, 1955, the benefit due on account of the death of B. The provisions of the profit-sharing plan give each participating employee, in case of termination of employment, a 10 percent vested interest in the amount accumulated in his account for each year of participation in the plan, but, in case of death, the entire credit to the participant's account is to be paid to his beneficiary. At the time of B's death, he had been a participant for five years. The accumulation in his account was $8,000, and the amount which would have been distributable to him in the event of termination of employment was $4,000 (50 percent of $8,000). After his death, $8,000 is paid to his beneficiary in a lump sum. (It may be noted that these are the same facts as in example (5) of subparagraph (2) of this paragraph except that the employee has been a participant for five years instead of three and the plan is a ''qualified'' plan.) It is immaterial that the employee had a nonforfeitable right to $4,000, because the payment of the $8,000 to the beneficiary is the payment of the ''total distributions payable'' within one taxable year of the distributee to which subdivision (i) of this subparagraph applies. Assuming no other death benefits are involved, the beneficiary may exclude $5,000 of the $8,000 payment from gross income.

Example (3). The facts are the same as in example (2) except that the beneficiary is entitled to receive only the $4,000 to which the employee had a nonforfeitable right and elects, 30 days after B's death, to receive it over a period of ten years. Since the ''total distributions payable'' are not paid within one taxable year of the distributee, no exclusion from gross income is allowable with respect to the $4,000.

Example (4). The X Corporation instituted a trust, forming part of a ''qualified'' profit-sharing plan for its employees, the cost thereof being borne entirely by the corporation. The plan provides, in part, that if, after 10 or more years of service, an employee leaves the employ of the corporation, either voluntarily or involuntarily, before retirement, a percentage of the reserve provided for the employee in the trust fund will be paid to the employee as follows: 10 to 15 years of service, 25 percent; 15 to 20 years of service, 50 percent; 20 to 25 years of service, 75 percent; 25 or more years of service, 100 percent. The plan further provides that if an employee dies before reaching retirement age, his beneficiary will receive a percentage of the reserve provided for the employee in the trust fund, on the same basis as shown in the preceding sentence. A, an employee of the X Corporation for 17 years, died before attaining retirement age while in the employ of the corporation. At the time of his death, $15,000 was the reserve provided for him in the trust fund. His beneficiary receives $7,500 in a lump sum, an amount equal to 50 percent of the reserve provided for A's retirement. The beneficiary may exclude from gross income (assuming no other death benefits are involved) $5,000 of the $7,500, since the latter amount constitutes ''total distributions payable'' paid within one taxable year of the distributee, to which subdivision (i) of this subparagraph applies.

(4)(i) Notwithstanding the rule stated in subparagraph (1) of this paragraph and illustrated in subparagraph (2) of this paragraph, the exclusion from gross income under section 101(b) also applies (but only to the extent provided in the next sentence) to amounts with respect to which the deceased employee possessed, immediately before his death, a nonforfeitable right to receive the amounts while living—

(a) If such amounts are paid under an annuity contract purchased by an employer which is an organization referred to in section 170(b)(1)(A) (ii) or (vi) or which is a religious organization (other than a trust) and which is exempt from tax under section 501(a).

(b) If such amounts are paid as part of a ''total payment'' with respect to the deceased employee; and

(c) If such ''total payment'' is paid in full within one taxable year of the payee beginning after December 31, 1957.

However, the amount that is excludable under section 101(b) by reason of this subparagraph shall not exceed an amount which bears the same ratio to the amount which would be includible in the payee's gross income if it were not for the second sentence of section 101(b)(2)(B) and this subparagraph, as the amount contributed by the employer for the annuity contract that was excludable from the deceased employee's gross income under paragraph (b) of § 1.403(b)–1 bears to the total amount contributed by the employer for the annuity contract. See section 101(b)(2)(B)(iii). For purposes of this subparagraph, a ''total payment'' means a payment of the balance to the credit of an employee with respect to all ''section 403(b) annuities'' purchased by the employer which becomes payable to the payee by reason of the employee's death, either before or after separation from the service. An annuity contract will be regarded as a ''section 403(b) annuity'' if any amount contributed (or considered as contributed under paragraph (b)(2) of § 1.403(b)–1) by the employer for such contract was excludable from the employee's gross income under paragraph (b) of § 1.403(b)–1. Under this definition, therefore, an annuity contract may be regarded as a ''section 403(b) annuity'' even though some of the employer's contributions for the contract were not excludable from the employee's gross income under paragraph (b) of § 1.403(b)–1 because, for example, the employer was not an exempt organization when such contributions were paid. For purposes of computing the ratio described in this subdivision in such a case, the total amount contributed by the employer for the contract includes the amounts contributed by the employer when it was not an exempt organization.

(ii) This subparagraph does not relate to any amounts with respect to which the deceased employee did not possess, immediately before his death, a nonforfeitable right to receive the amounts while living. Such amounts are excludable under the provisions of section 101(b) without regard to section 101(b)(2)(B) and this subparagraph. Thus, if a ''total payment'' received by a beneficiary of a deceased employee under an annuity contract purchased by an organization described in subdivision (i)*(a)* of this subparagraph consists both of amounts with respect to which the deceased employee possessed, immediately before his death, a nonforfeitable right to receive the amounts while living and of amounts with respect to which the deceased employee did not possess such a nonforfeitable right, only those amounts with respect to which the deceased employee possessed such a nonforfeitable right are amounts to which this subparagraph applies. Therefore, for purposes of computing the ratio described in subdivision (i) of this subparagraph in such a case, there shall be taken into account only the employer contributions attributable to those amounts with respect to which the deceased employee possessed, immediately before his death, a nonforfeitable right to receive the amounts while living. See example (3) of subdivision (v) of this subparagraph. In no event, however, may the total amount excludable under section 101(b) with respect to any employee exceed $5,000 (See paragraph (a)(3) of this section).

(iii)*(a)* In any case when the deceased employee's interest in the employer's contributions for an annuity contract was forfeitable at the time the contributions were made but, at a subsequent date prior to his death, such interest changed to a nonforfeitable interest, then, for purposes of computing the ratio described in subdivision (i) of this subparagraph, the cash surrender value of the contract on the date of the change (except to the extent attributable to employee contributions) shall be considered as the amount contributed by the employer for the contract. In such a case, if only part of the deceased employee's interest in the annuity changed from a forfeitable to a nonforfeitable interest, then only the corresponding part of the cash surrender value of the contract on the date of the change shall be considered as the amount contributed by the employer for the contract. Similarly, if part of the deceased employee's interest in the annuity contract changed from a forfeitable to a nonforfeitable interest on a particular date and another part of his interest so changed on a subsequent date, it is necessary, in order to compute the amount contributed by the employer for the contract, to first determine (under the rules in the preceding sentence) the amount that is considered as the amount contributed by the employer with respect to each change, and then to add these amounts together. For purposes of computing the ratio described in subdivision (i) of this subparagraph in all of the above cases, the amount contributed by the employer that was excludable from the employee's gross income under paragraph (b) of § 1.403(b)–1 is that amount which, under paragraph (b)(2) of such section, was considered as employer contributions and which, under such paragraph (b) of § 1.403(b)–1, was excludable from the deceased employee's gross income for the taxable year in which the change occurred.

(b) This subdivision (iii) may be illustrated by the following examples:

Example (1). X Organization contributed $4,000 toward the purchase of an annuity contract for A, an employee who died in 1970. At the time they were made, A's interest in such contributions was forfeitable. A made no contributions toward the purchase of the annuity contract. On January 1, 1960, A's entire interest in the annuity contract changed to a nonforfeitable interest. At the time of such change, the cash surrender value of the contract was $5,000. For purposes of the ratio described in subdivision (i) of this subparagraph, the total amount contributed by X Organization for the annuity contract is $5,000. If any part of such $5,000 was excludable under paragraph (b) of § 1.403(b)–1 from A's gross income for his taxable year in which the change occurred, the amount so excludable shall be considered as the amount contributed for the contract by the employer that was excludable from the employee's gross income under paragraph (b) of § 1.403(b)–1.

Example (2). Assume the same facts as in example (1) except that only one-half of A's interest in the annuity contract changed to a nonforfeitable interest on January 1, 1960, and that no other part of his interest so changed during his lifetime. For purposes of the ratio described in subdivision (i) of this subparagraph, the total amount contributed by X Organization for the annuity contract is $2,500 (½ of the cash surrender value of the annuity contract on the date of the change). To the extent such $2,500 was, under paragraph (b) of § 1.403(b)–1, excludable from A's gross income for the taxable year of the change, it is considered as the amount contributed by the employer that was excludable under paragraph (b) of § 1.403(b)–1.

Example (3). Assume the same facts as in example (1) except that one-half of A's interest in the annuity contract changed to a nonforfeitable interest on January 1, 1960, and the other half of his interest changed to a nonforfeitable interest on January 1, 1965. On January 1, 1965, the cash surrender value of the annuity contract was $6,000. For purposes of the ratio described in subdivision (i) of this subparagraph, the total amount contributed by X organization for the annuity contract is $5,500 (*i.e.*, ½×$5,000 plus ½×$6,000). The amount contributed by the employer that was excludable from A's gross income under paragraph (b) of § 1.403(b)–1 is an amount equal to the sum of the amount that was, under such paragraph, excludable from A's gross income for the taxable year during which the first change occurred and the amount that was, under such paragraph, excludable from A's gross income for the taxable year in which the second change occurred.

(iv) For purposes of this subparagraph, an annuity contract will be considered to have been purchased by an employer which is an organization referred to in section 170(b)(1)(A) (ii) or (vi) or which is a religious organization (other than a trust) and which is exempt from tax under section 501(a), if any of the contributions paid toward the purchase price of such contract by the employer were paid at a time when the employer was such an organization.

Thus an annuity contract may be regarded as purchased by such an organization even though part of the organization's contributions for such annuity contract were paid at a time when the organization was not such an exempt organization.

(v) The application of this subparagraph may be illustrated by the following examples:

Example (1). The widow of A, a deceased employee, elects, under an annuity contract purchased for A by X Organization, to receive in a lump sum the present value of such annuity contract as of the date of A's death. Such present value is $6,000 and is received by the widow in a taxable year beginning after December 31, 1957. X Organization contributed $3,000 toward the purchase of the annuity contract and A contributed $2,000 toward such purchase. A's interest in X Organization's contributions was nonforfeitable at the time such contributions were made. Thus, just before his death, A's entire interest in the annuity contract was a nonforfeitable interest and, if he had retired at that time, he could have received the present value of $6,000. The whole amount of the $3,000 contributed by X Organization for the annuity contract was excludable from A's gross income under paragraph (b) of § 1.403(b)–1. This annuity contract was the only annuity contract purchased by X Organization for A and was not purchased as part of a qualified plan. However, all the contributions paid by X Organization were paid at a time when X Organization was an organization referred to in section 170(b)(1)(A)(ii) and exempt from tax under section 501(a). The amount that A's widow may exclude from gross income (assuming no other death benefits) is computed in the following manner:

(a) Amount includible in gross income without regard to second sentence of section 101(b)(2)(B) ($6,000 minus $2,000 contributed for contract by A)	$4,000
(b) Total employer contributions for the contract	$3,000
(c) Amount of employer contributions for the contract that was excludable under paragraph (b) of § 1.403(b)–1	$3,000
(d) Percent of total employer contributions for the contract that were excludable under paragraph (b) of § 1.403(b)–1 *((c) ÷ (b))*	100%
(e) Amount to which section 101(b) exclusion applies *((d) × (a))*	$4,000

Example (2). The facts are the same as in example (1) except that only $2,000 of X Organization's contributions for the annuity contract was excludable from A's gross income under paragraph (b) of § 1.403(b)–1 and that the remaining $1,000 was includible in A's gross income for the taxable years during which such amounts were contributed by X Organization. The amount that A's widow may exclude from gross income (assuming no other death benefits) is computed in the following manner:

(a) Amount includible in gross income without regard to second sentence of section 101(b)(2)(B) ($6,000 minus $2,000 contributed for contract by A and $1,000 of X Organization's contributions includible in A's gross income)	$3,000
(b) Total employer contributions for the contract	$3,000
(c) Amount of employer contributions for the contract that was excludable under paragraph (b) of § 1.403(b)–1	$2,000
(d) Percent of total employer contributions for the contract that were excludable under paragraph (b) of § 1.403(b)–1 *((c) ÷ (b))*	67%
(e) Amount to which section 101(b) exclusion applies *((d) × (a))*	$2,000

Example (3). The widow of B, a deceased employee, elects, under an annuity contract purchased for B by Y Organization, to receive in a lump sum the present value of such annuity contract as of the date of B's death. Such present value is $6,000 and is received by the widow in a taxable year beginning after December 31, 1957. Y Organization contributed $4,000 toward the purchase of the contract; whereas B made no contributions toward the purchase of the contract. This annuity contract was the only annuity contract purchased by Y Organization for B and was not purchased as part of a ''qualified'' plan. However, all the contributions paid by Y Organization were paid at a time when it was an organization referred to in section 170(b)(1)(A)(ii) and exempt from tax under section 501(a). B's interest in Y Organization's contributions was, at the time they were paid, forfeitable. However, prior to his death, one-half of B's interest in the annuity contract changed from a forfeitable to a nonforfeitable interest. Therefore, just before his death, B could have obtained $3,000 under the annuity contract if he had retired at that time. On the date of the change, the cash surrender value of the annuity contract was $5,000. As a result of the change, $1,500 was, under paragraph (b) of § 1.403(b)–1, excludable from B's gross income, and $600 was includible in his gross income for the taxable year in which the change occurred. Part of the value of the annuity contract on the date of the change was attributable to contributions made by Y Organization prior to January 1, 1958, and, consequently, was neither excludable from B's gross income under paragraph (b) of § 1.403(b)–1 nor includible in B's gross income (see paragraph (b) of § 1.403(d)–1). The amount that B's widow may exclude from gross income (assuming no other death benefits) is computed in the following manner:

(a) Amount of ''total payment'' with respect to which A had a forfeitable right at time of death. ($\frac{1}{2}$×$6,000)	$3,000
(b) Amount includible in gross income without regard to second sentence of section 101(b)(2)(B) ($\frac{1}{2}$×$6,000 less $600 includible in B's gross income for year when his rights changed to nonforfeitable rights)	$2,400

(c) Total employer contributions for the contract (½ of cash surrender value of contract on date B's rights changed to nonforfeitable rights)	$2,500
(d) Amount of employer contributions for the contract that was excludable under paragraph (b) of § 1.403(b)–1	$1,500
(e) Percent of total employer contributions for the contract that were excludable under paragraph (b) of § 1.403(b)–1 *((d÷(c))*	60%
(f) Amount to which section 101(b) exclusion applies by reason of the second sentence of section 101(b)(2)(B) *((e)×(b))*	$1,440
(g) Total amount to which section 101(b) exclusion applies *((a)+(f))*	$4,440

(e) *Annuity payments.* (1) Where death benefits are paid in the form of annuity payments, the following rules shall govern for purposes of the exclusion provided in section 101(b):

(i) The exclusion from gross income provided by section 101(b) does not apply to amounts, paid as an annuity, with respect to which the employee possessed, immediately before his death, a nonforfeitable right to receive the amounts while living, or to amounts paid as an annuity in lieu thereof. See paragraph (d) of this section.

(ii) Under section 101(b)(2)(C), no exclusion is allowable for amounts received by a surviving annuitant under a joint and survivor's annuity contract if the annuity starting date (as defined in section 72(c)(4) and paragraph (b) of § 1.72–4) occurs before the death of the employee. If the annuity starting date occurs after the death of the employee, the joint and survivor's annuity contract shall be treated as an annuity to which section 101(b)(2)(D) applies. See subdivision (iii) of this subparagraph.

(iii)*(a)* Subject to the other limitations stated in section 101(b) and in this section (see section 101(b)(2)(D)), the amount to which the exclusion of section 101(b) shall apply, with respect to ''amounts received as an annuity'' (as defined in paragraph (b) of § 1.72–2) shall be the amount by which the present value of the annuity to be paid to the beneficiary, computed as of the date of the employee's death, exceeds the value (if any) of whichever of the following is the larger:

(1) Amounts contributed by the employee (determined in accordance with the provisions of section 72 and the regulations thereunder), or

(2) Amounts with respect to which the employee possessed, immediately before his death, a nonforfeitable right to receive the amounts while living, or amounts paid in lieu thereof (see paragraph (d) of this section).

(b) The present value of an annuity (immediately before the death of the employee), to the employee, or (immediately after the death of the employee), to his estate or beneficiary, shall be determined as follows:

(*1*) In the case of an annuity paid by an insurance company or by an organization (other than an insurance company) regularly engaged in issuing annuity contracts with an insurance company as the coinsurer or reinsurer of the obligations under the contract, by use of the discount interest rates and mortality tables used by the insurance company involved to determine the installment benefits; and

(*2*) In the case of an annuity issued after November 23, 1984, to which paragraph (e)(1)(iii)(*b*)(*1*) of this section is not applicable, by use of the appropriate tables in § 20.2031–7 of this chapter (Estate Tax Regulations).

(iv) Any amount subject to section 101(b)(2)(D) which is excludable under section 101(b) (see subdivision (iii) of this subparagraph) shall, for purposes of section 72, be treated as additional consideration paid by the employee. See paragraph (b) of § 1.72–8.

(v) Where more than one beneficiary, or more than one death benefit, is involved, the exclusion provided by section 101(b) shall be apportioned to the various beneficiaries and benefits in accordance with the proportion that the present value of each benefit bears to the total present value of all the benefits.

(2) The application of the principles of this paragraph may be illustrated by the following examples:

Example (1). (i) A died on January 1, 1969. Under the plan of the X Corporation, W, who is the widow of employee A, and who is 55 years old at the time of A's death, is entitled to an immediate annuity of $2,000 per year during her life and C, the minor child of A, is entitled to receive $1,000 per year for 15 years. A made no contributions under the plan and died while still employed by the X Corporation. At the time of A's death, the amount in his account is $18,000. Under the terms of the plan, this amount would have been distributable to him on account of voluntary termination of employment, but would not have been payable after his death except in the form of the annuities just described. This amount, accordingly, constitutes a nonforfeitable interest in lieu of which the annuities are paid. The exclusion does not apply, except to the extent that the present value of the annuities exceeds $18,000, whether or not the plan is ''qualified'', since the total of the amount in A's account will not be paid within one taxable year of the distributees. See subparagraph (1)(i) of this paragraph.

(ii) The computation of the exclusion applicable to the interests of W and C (assuming that the payments will not be made by an insurance company or some other organization regularly engaged in issuing annuity contracts) is, by application of the tables in §20.2031–7 of this chapter (Estate Tax Regulations), as follows: The present value of W's interest is $26,243.60, determined by multiplying the annual payment of $2,000 by 13.1218 (the factor in Table I for a person aged 55); the present value of C's interest is $11,517.40, determined by multiplying the yearly payment of $1,000 by 11.5174 (the factor in Table II for payments for a term certain of 15 years). The present value of both annuities is $37,761 and (assuming no other death benefits are involved), the total amount excludable is $5,000, because the total present value of the annuities exceeds the employee's nonforfeitable interest by more than $5,000 ($37,761 minus $18,000 equal $19,761). The exclusion allocable to W's interest is $26,243.60/$37,761 times $5,000, or $3,474.96; the exclusion allocable to C's interest is $11,517.40/$37,761 times $5,000, or $1,525.04. That portion of the death benefit exclusion as so determined for each beneficiary is to be treated as consideration paid by the employee for purposes of section 72.

Example (2). The facts are the same as in example (1), except that the nonforfeitable interest of A, at the time of his death, amounted to $33,761. Since the present value of both annuities ($37,761) exceeds the value of such nonforfeitable interest by only $4,000, the latter amount is the total amount excludable from the gross income of the beneficiaries. This $4,000 exclusion is to be divided in the same proportions as those indicated in example (1). Thus, the exclusion allocable to W's interest is $26,243.60/$37,761 times $4,000, or $2,779.97; and the exclusion allocable to the interest of C is $11,517.40/$37,761 times $4,000, or $1,220.03. That portion of the death benefit exclusion as so determined for each beneficiary is to be treated as consideration paid by the employee for purposes of section 72.

(f) *Distributions on behalf of a self-employed individual.* (1) Under sections 401(c)(1) and 403(a)(3), certain self-employed individuals may be covered by a pension or profit-sharing plan described in section 401(a) and exempt under section 501(a) or under an annuity plan described in section 403(a). However, a payment pursuant to the provisions of any such plan by reason of the death of an individual who participated in such a plan as a self-employed individual immediately before his retirement or death to the beneficiary or estate of such individual does not qualify for the exclusion provided by section 101(b).

(2) The application of this paragraph may be illustrated by the following examples:

Example (1). From 1950 to 1965, A was an employee of B, a sole proprietor. In 1963, B established a qualified pension plan covering A and all other persons who had been employed by B for more than 3 years. In 1965, A acquired from B a 40-percent interest in the capital and profits of the business. A continued to participate in the pension plan as a self-employed individual. In 1970, A died and his widow, in compliance with one of the provisions of the pension plan, elected to receive all of the benefits accrued to A prior to his death in a lump-sum distribution. As A participated in the plan as a self-employed individual immediately prior to his death, A's widow may not exclude any portion of such distribution from her gross income under section 101(b).

Example (2). A, an attorney, is employed by the X Company in their legal department. He is covered by the pension plan that X has established for its employees. Under the terms of A's contract of employment with X, A is permitted to carry on the private practice of law in his off-duty hours. A establishes his own pension plan with respect to his earnings from his private practice. On A's death, his widow elected to receive a lump-sum distribution with respect to any benefits accrued to A under both X's pension plan and A's own pension plan. To the extent that such payment otherwise complies with the requirements of section 101(b), up to $5,000 of the amount paid by X may be excluded from her gross income. No part of the distribution from A's own pension plan may be excluded from her gross income under section 101(b) because A participated in the plan as a self-employed individual immediately before his death.

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