determined by multiplying the number of payments to be made each year *(a)* by the number of years payments are to be made, or *(b)* if payments are to be made for a life or lives, by the multiple found by the use of the appropriate tables contained in §1.72–9, as adjusted in accordance with the table in paragraph (a)(2) of §1.72–5.

(iii) For an example of the computation to be made in accordance with this subparagraph and a special election which may be made in a taxable year subsequent to a taxable year in which the total payments received under a contract described in this subparagraph are less than the total of the amounts excludable from gross income in such year under subdivision (i) of this subparagraph, see paragraph (d)(3) of §1.72–4.

[T.D. 6500, 25 FR 11402, Nov. 26, 1960, as amended by T.D. 6497, 25 FR 10019, Oct. 20, 1960; T.D. 6885, 31 FR 7798, June 2, 1966]

§ 1.72–3 Excludable amounts not income.

In general, amounts received under contracts described in paragraph (a)(1) of §1.72–2 are not to be included in the income of the recipient to the extent that such amounts are excludable from gross income as the result of the application of section 72 and the regulations thereunder.

§ 1.72–4 Exclusion ratio.

(a) *General rule.* (1)(i) To determine the proportionate part of the total amount received each year as an annuity which is excludable from the gross income of a recipient in the taxable year of receipt (other than amounts received under (*a*) certain employee annuities described in section 72(d) and §1.72–13, or (*b*) certain annuities described in section 72(o) and §1.122–1), an exclusion ratio is to be determined for each contract. In general, this ratio is determined by dividing the investment in the contract as found under §1.72–6 by the expected return under such contract as found under §1.72–5. Where a single consideration is given for a particular contract which provides for two or more annuity elements, an exclusion ratio shall be determined for the contract as a whole by dividing the investment in such contract by the aggregate

of the expected returns under all the annuity elements provided thereunder. However, where the provisions of paragraph (b)(3) of §1.72–2 apply to payments received under such a contract, see paragraph (b)(3) of §1.72–6. In the case of a contract to which §1.72–6(d) (relating to contracts in which amounts were invested both before July 1, 1986, and after June 30, 1986) applies, the exclusion ratio for purposes of this paragraph (a) is determined in accordance with §1.72–6(d) and, in particular, §1.72–6(d)(5)(i).

(ii) The exclusion ratio for the particular contract is then applied to the total amount received as an annuity during the taxable year by each recipient. See, however, paragraph (e)(3) of §1.72–5. Any excess of the total amount received as an annuity during the taxable year over the amount determined by the application of the exclusion ratio to such total amount shall be included in the gross income of the recipient for the taxable year of receipt.

(2) The principles of subparagraph (1) may be illustrated by the following example:

Example. Taxpayer A purchased an annuity contract providing for payments of $100 per month for a consideration of $12,650. Assuming that the expected return under this contract is $16,000 the exclusion ratio to be used by A is $12,650÷16,000; or 79.1 percent (79.06 rounded to the nearest tenth). If 12 such monthly payments are received by A during his taxable year, the total amount he may exclude from his gross income in such year is $949.20 ($1,200×79.1 percent).The balance of $250.80 ($1,200 less $949.20) is the amount to be included in gross income. If A instead received only five such payments during the year, he should exclude $395.50 (500×79.1 percent) of the total amounts received.

For examples of the computation of the exclusion ratio in cases where two annuity elements are acquired for a single consideration, see paragraph (b)(1) of §1.72–6.

(3) The exclusion ratio shall be applied only to amounts received as an annuity within the meaning of that term under paragraph (b) (2) and (3) of §1.72–2. Where the periodic payments increase in amount after the annuity starting date in a manner not provided by the terms of the contract at such date, the portion of such payments representing the increase is not an