

§ 1.72-5

any of the annuity elements. To obtain this ratio, the investment in the contract determined in accordance with § 1.72-6 shall be divided by the aggregate of the expected returns found with respect to each of the annuity elements in accordance with § 1.72-5. For this purpose, it is immaterial that payments under one or more of the annuity elements involved have not commenced at the time when an amount is first received as an annuity under one or more of the other annuity elements.

(ii) The exclusion ratio found under subdivision (i) of this subparagraph does not apply to:

(a) An annuity element payable to a surviving annuitant under a joint and survivor annuity contract to which section 72(i) and paragraphs (b)(3) and (e)(3) of § 1.72-5 apply, or to

(b) A contract under which one or more of the constituent annuity elements provides for payments described in paragraph (b)(3) of § 1.72-2.

For rules with respect to a contract providing for annuity elements described in (b) of this subdivision, see subparagraph (2) of this paragraph.

(2) If one or more of the annuity elements under a contract described in paragraph (a)(2) of § 1.72-2 provides for payments to which paragraph (b)(3) of § 1.72-2 applies:

(i) With respect to the annuity elements to which paragraph (b)(3) of § 1.72-2 does not apply, an exclusion ratio shall be determined by dividing the portion of the investment in the entire contract which is properly allocable to all such elements (in the manner provided in paragraph (b)(3)(ii) of § 1.72-6) by the aggregate of the expected returns thereunder and such ratio shall be applied in the manner described in subdivision (i) of subparagraph (1); and

(ii) With respect to the annuity elements to which paragraph (b)(3) of § 1.72-2 does apply, the investment in the entire contract shall be reduced by the portion thereof found in subdivision (i) of this subparagraph and the resulting amount shall be used to determine the extent to which the aggregate of the payments received during the taxable year under all such elements is excludable from gross income. The amount so excludable shall be allo-

cated to each recipient under such elements in the same ratio that the total of payments he receives each year bears to the total of the payments received by all such recipients during the year. The exclusion ratio with respect to the amounts so allocated shall be 100 percent. See paragraph (f)(2) of § 1.72-5 and paragraph (b)(3) of § 1.72-6.

(iii) 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, this paragraph (e) is applied in the manner prescribed in § 1.72-6(d) and, in particular, § 1.72-6(d)(5)(iv).

[T.D. 6500, 25 FR 11402, Nov. 26, 1960, as amended by T.D. 7352, 40 FR 16663, Apr. 14, 1975; T.D. 8115, 51 FR 45691, Dec. 19, 1986; 52 FR 10223, Mar. 31, 1987]

§ 1.72-5 Expected return.

(a) *Expected return for but one life.* (1) If a contract to which section 72 applies provides that one annuitant is to receive a fixed monthly income for life, the expected return is determined by multiplying the total of the annuity payments to be received annually by the multiple shown in Table I or V (whichever is applicable) of § 1.72-9 under the age (as of the annuity starting date) and, if applicable, sex of the measuring life (usually the annuitant's). Thus, where a male purchases a contract before July 1, 1986, providing for an immediate annuity of \$100 per month for his life and, as of the annuity starting date (in this case the date of purchase), the annuitant's age at his nearest birthday is 66, the expected return is computed as follows:

Monthly payment of \$100×12 months equals annual payment of	\$1,200
Multiple shown in Table I, male, age 66	14.4
Expected return (1,200×14.4)	17,280

If, however, the taxpayer had purchased the contract after June 30, 1986, the expected return would be \$23,040, determined by multiplying 19.2 (multiple shown in Table V, age 66) by \$1,200.

(2)(i) If payments are to be made quarterly, semiannually, or annually, an adjustment of the applicable multiple shown in Table I or V (whichever

Internal Revenue Service, Treasury

§ 1.72-5

is applicable) may be required. A further adjustment may be required where the interval between the annuity starting date and the date of the first payment is less than the interval between future payments. Neither adjustment

shall be made, however, if the payments are to be made more frequently than quarterly. The amount of the adjustment, if any, is to be found in accordance with the following table:

If the number of whole months from the annuity starting date to the first payment date is—	0-1	2	3	4	5	6	7	8	9	10	11	12
And the payments under the contract are to be made:												
Annually	+0.5	+0.4	+0.3	+0.2	+0.1	0	0	-0.1	-0.2	-0.3	-0.4	-0.5
Semiannually	+2	+1	0	0	-1	-2						
Quarterly	+1	0	-1									

Thus, for a male, age 66, the multiple found in Table I, adjusted for quarterly payments the first of which is to be made one full month after the annuity starting date, is 14.5 (14.4+0.1); for semi-annual payments the first of which is to be made six full months from the annuity starting date, the adjusted multiple is 14.2 (14.4-0.2); for annual payments the first of which is to be made one full month from the annuity starting date, the adjusted multiple is 14.9 (14.4+0.5). If the annuitant in the example shown in subparagraph (1) of this paragraph were to receive an annual payment of \$1,200 commencing 12 full months after his annuity starting date, the amount of the expected return would be \$16,680 (\$1,200×13.9 [14.4-0.5]). Similarly, for an annuitant, age 50, the multiple found in Table V, adjusted for quarterly payments the first of which is to be made one full month after the annuity starting date, is 33.2 (33.1+0.1); for semiannual payments the first of which is to be made six full months from the annuity starting date, the adjusted multiple is 32.9 (33.1-0.2); for annual payments the first of which is to be made one full month from the annuity starting date, the adjusted multiple is 33.6 (33.1+0.5).

(ii) Notwithstanding the table in subdivision (i) of this subparagraph, adjustments of multiples for early or other than monthly payments determined prior to February 19, 1956, under the table prescribed in paragraph 1(b)(4) of T.D. 6118 (19 FR 9897, C.B.

1955-1, 699), approved December 30, 1954, need not be redetermined.

(3) If the contract provides for fixed payments to be made to an annuitant until death or until the expiration of a specified limited period, whichever occurs earlier, the expected return of such temporary life annuity is determined by multiplying the total of the annuity payments to be received annually by the multiple shown in Table IV or VIII (whichever is applicable) of §1.72-9 for the age (as of the annuity starting date) and, if applicable, sex of the annuitant and the nearest whole number of years in the specified period. For example, if a male annuitant, age 60 (at his nearest birthday), is to receive \$60 per month for five years or until he dies, whichever is earlier, and there is no post-June 1986, investment in the contract, the expected return under such a contract is \$3,456, computed as follows:

Monthly payments of \$60×12 months equals annual payment of	\$720
Multiple shown in Table IV for male, age 60, for term of 5 years ...	4.8
Expected return for 5 year temporary life annuity of \$720 per year (\$720×4.8)	\$3,456

If the annuitant purchased the same contract after June 30, 1986, the expected return under the contract would be \$3,528, computed as follows:

Monthly payments of \$60×12 months equals annual payment of	\$720.00
---	----------

§ 1.72-5

26 CFR Ch. I (4-1-04 Edition)

Multiple shown in Table VIII for annuitant, age 60, for term of 5 years	4.9
<hr/>	
Expected return for 5-year temporary life annuity of \$720 per year (\$720×4.9)	\$3,528.00

The adjustment provided by subparagraph (2) of this paragraph shall not be made with respect to the multiple found in Table IV or VIII (whichever is applicable).

(4) If the contract provides for payments to be made to an annuitant for the annuitant's lifetime, but the amount of the annual payments is to be decreased after the expiration of a specified limited period, the expected return is computed by considering the contract as a combination of a whole life annuity for the smaller amount plus a temporary life annuity for an amount equal to the difference between the larger and the smaller amount. For example, if a male annuitant, age 60, is to receive \$150 per month for five years or until his earlier death, and is to receive \$90 per month for the remainder of his lifetime after such five years, the expected return is computed as if the annuitant's contract consisted of a whole life annuity for \$90 per month plus a five year temporary life annuity of \$60 per month. In such circumstances, the expected return if there is no post-June 1986 investment in the contract is computed as follows:

Monthly payments of \$90×12 months equals annual payment of	\$1,080
Multiple shown in Table I for male, age 60	18.2
<hr/>	
Expected return for whole life annuity of \$1,080 per year	\$19,656
Expected return for 5-year temporary life annuity of \$720 per year (as found in subparagraph (3) of this paragraph (a))	\$3,456
<hr/>	
Total expected return	\$23,112

If the annuitant purchased the same contract after June 30, 1986, the expected return would be \$29,664, computed as follows:

Monthly payments of \$90×12 months equals annual payment of	\$1,080
---	---------

Multiple shown in Table V for annuitant, age 60	24.2
<hr/>	
Expected return for whole life annuity of \$1,080 per year	\$26,136
Plus: Expected return for 5-year temporary life annuity of \$720 per year (as found in subparagraph (3) of this paragraph (a))	\$3,528
<hr/>	
Total expected return	\$29,664

If payments are to be made quarterly, semiannually, or annually, an appropriate adjustment of the multiple found in Table I or V (whichever is applicable) for the whole life annuity should be made in accordance with subparagraph (2) of this paragraph.

(5) If the contract described in subparagraph (4) of this paragraph provided that the amount of the annual payments to the annuitant were to be increased (instead of decreased) after the expiration of a specified limited period, the expected return would be computed as if the annuitant's contract consisted of a whole life annuity for the larger amount minus a temporary life annuity for an amount equal to the difference between the larger and smaller amount. Thus, if the annuitant described in subparagraph (4) of this paragraph were to receive \$90 per month for five years or until his earlier death, and to receive \$150 per month for the remainder of his lifetime after such five years, the expected return would be computed by subtracting the expected return under a five year temporary life annuity of \$60 per month from the expected return under a whole life annuity of \$150 per month. In such circumstances, the expected return if there is no post-June 1986 investment in the contract is computed as follows:

Monthly payments of \$150×12 months equals annual payment of	\$1,800
Multiple shown in Table I (male, age 60)	18.2
<hr/>	
Expected return for annuity for whole life of \$1,800 per year	\$32,760
Less expected return for 5-year temporary life annuity of \$720 per year (as found in subparagraph (3))	\$3,456
<hr/>	

Internal Revenue Service, Treasury

§ 1.72-5

Net expected return	\$29,304
If the annuitant purchased the same contract after June 30, 1986, the expected return would be \$40,032, computed as follows:	
Monthly payments of \$150×12 months equals annual payments of	\$1,800
Multiple shown in Table V (age 60)	24.2
Expected return for annuity for whole life of \$1,800 per year	\$43,560
Less expected return for 5-year temporary life annuity of \$720 per year (as found in subparagraph (3) of this paragraph (a))	\$3,528
Net expected return	\$40,032

If payments are to be made quarterly, semiannually, or annually, an appropriate adjustment of the multiple found in Table I or V (whichever is applicable) for the whole life annuity should be made in accordance with subparagraph (2) of this paragraph.

(b) *Expected return under joint and survivor and joint annuities.* (1) In the case of a joint and survivor annuity contract involving two annuitants which provides the first annuitant with a fixed monthly income for life and, after the death of the first annuitant, provides an identical monthly income for life to a second annuitant, the expected return shall be determined by multiplying the total amount of the payments to be received annually by the multiple obtained from Table II or VI (whichever is applicable) of §1.72-9 under the ages (as of the annuity starting date) and, if applicable, sexes of the living annuitants. For example, a husband purchases a joint and survivor annuity contract providing for payments of \$100 per month for life and, after his death, for the same amount to his wife for the remainder of her life. As of the annuity starting date his age at his nearest birthday is 70 and that of his wife at her nearest birthday is 67. If there is no post-June 1986 investment in the contract, the expected return is computed as follows:

Monthly payments of \$100×12 months equals annual payment of	\$1,200
--	---------

Multiple shown in Table II (male, age 70, female, age 67)	19.7
---	------

Expected return (\$1,200×19.7) ...	\$23,640
------------------------------------	----------

If the annuitants purchased the same contract after June 30, 1986, the expected return would be \$26,400, computed as follows:

Monthly payments of \$100×12 months equals annual payment of	\$1,200
Multiple shown in Table VI (ages 70, 67)	22.0

Expected return (\$1,200×22.0) ...	\$26,400
------------------------------------	----------

If payments are to be made quarterly, semiannually, or annually, an appropriate adjustment of the multiple found in Table II or VI (whichever is applicable) should be made in accordance with paragraph (a)(2) of this section.

(2) If a contract of the type described in subparagraph (1) of this paragraph provides that a different (rather than an identical) monthly income is payable to the second annuitant, the expected return is computed in the following manner. The applicable multiple in Table II or VI (whichever is applicable) is first found as in the example in subparagraph (1) of this paragraph. The multiple applicable to the first annuitant is then found in Table I or V (whichever is applicable) as though the contract were for a single life annuity. The multiple from Table I or V is then subtracted from the multiple obtained from Table II or VI and the resulting multiple is applied to the total payments to be received annually under the contract by the second annuitant. The result is the expected return with respect to the second annuitant. The portion of the expected return with respect to payments to be made during the first annuitant's life is then computed by applying the multiple found in Table I or V to the total annual payments to be received by such annuitant under the contract. The expected returns with respect to each of the annuitants separately are then aggregated to obtain the expected return under the entire contract.

Example (1). A husband purchases a joint and survivor annuity providing for payments of \$100 per month for his life and, after his death, payments to his wife of \$50 per month

§ 1.72-5

for her life. As of the annuity starting date his age at his nearest birthday is 70 and that of his wife at her nearest birthday is 67. There is no post-June 1986 investment in the contract.

Multiple from Table II (male, age 70, female, age 67)	19.7
Multiple from Table I (male, age 70)	12.1
Difference (multiple applicable to second annuitant)	7.6
Portion of expected return, second annuitant (\$600×7.6) ..	\$4,560
Portion of expected return, first annuitant (\$1,200×12.1) ..	\$14,520
Expected return under the contract	\$19,080

The expected return thus found, \$19,080, is to be used in computing the amount to be excluded from gross income. Thus, if the investment in the contract in this example is \$14,310, the exclusion ratio is $\$14,310 \div \$19,080$; or 75 percent. The amount excludable from each monthly payment made to the husband is 75 percent of \$100, or \$75, and the remaining \$25 of each payment received by him shall be included in his gross income. After the husband's death, the amount excludable by the second annuitant (the surviving wife) would be 75 percent of each monthly payment of \$50, or \$37.50, and the remaining \$12.50 of each payment shall be included in her gross income.

Example (2). If the same contract were purchased after June 30, 1986, the expected return would be \$22,800, computed as follows:

Multiple from Table VI (ages 70, 67)	22.0
Multiple from Table V (age 70)	16.0
Difference (multiple applicable to second annuitant)	6.0
Portion of expected return, second annuitant (\$600×6.0) ..	\$3,600
Plus: Portion of expected return, first annuitant (\$1,200×16.0)	\$19,200
Expected return under the contract	\$22,800

If the investment in the contract is \$14,310, the exclusion ratio is $\$14,310 \div \$22,800$, or 62.8 percent. Thus, the husband would exclude \$62.80 of each \$100 payment received by him. After his death, his wife would exclude 62.8 percent, or \$31.40, of each \$50 monthly payment.

Example (3). If amounts were invested in the same contract both before July 1, 1986, and after June 30, 1986, and the election described in § 1.72-6(d)(6) were made, two exclu-

sion ratios would be determined pursuant to § 1.72-6(d). Assume that the husband's total investment in the contract is \$14,310 and that \$7,310 is the pre-July 1986 investment in the contract. The pre-July 1986 exclusion ratio would be $\$7,310 \div \$19,080$, or 38.3 percent. The post-June 1986 exclusion ratio would be $\$7,000 \div \$22,800$, or 30.7 percent. The husband would exclude \$69.00 ($\$38.30 + \30.70) of the \$100 monthly payment received by him. The remaining \$31.00 would be included in his gross income. After the husband's death, the amount excludable by his wife would be \$34.50 (38.3 percent of \$50 plus 30.7 percent of \$50). The remaining \$15.50 would be included in gross income.

The same method is used if the payments are to be increased after the death of the first annuitant. Thus, if the payments to be made until the husband's death were \$50 per month and his widow were to receive \$100 per month thereafter until her death, the 7.6 multiple in example (1) above would be applied to the \$100 payments, yielding an expected return with respect to this portion of the annuity contract of \$9,120 ($\$1,200 \times 7.6$). An expected return of \$7,260 ($\600×12.1) would be obtained with respect to the payments to be made to the husband, yielding a total expected return under the contract of \$16,380 ($\$9,120$ plus $\$7,260$). If payments are to be made quarterly, semiannually, or annually, an appropriate adjustment of the multiples found in Tables I and II or Tables V and VI (whichever are applicable) should be made in accordance with paragraph (a)(2) of this section.

(3) In the case of a joint and survivor annuity contract in respect of which the first annuitant died in 1951, 1952, or 1953, and the basis of the surviving annuitant's interest in the contract was determinable under section 113(a)(5) of the Internal Revenue Code of 1939, such basis shall be considered the "aggregate of premiums or other consideration paid" by the surviving annuitant for the contract. (For rules governing this determination, see 26 CFR (1939) 39.22(b)(2)-2 and 39.113(a)(5)-1 (Regulations 118).) In determining such an annuitant's investment in the contract, such aggregate shall be reduced by any amounts received under the contract by the surviving annuitant before the annuity starting date, to the extent such amounts were excludable from his gross income at the time of receipt.

The expected return of the surviving annuitant in such cases shall be determined in the manner prescribed in paragraph (a) of this section, as though the surviving annuitant alone were involved. For this purpose, the appropriate multiple for the survivor shall be obtained from Table I as of the annuity starting date determined in accordance with paragraph (b)(2)(i) of § 1.72-4.

(4) If a contract involving two annuitants provides for fixed monthly payments to be made as a joint life annuity until the death of the first annuitant to die (in other words, only as long as both remain alive), the expected return under such contract shall be determined by multiplying the total of the annuity payments to be received annually under the contract by the multiple obtained from Table IIA or VIA (whichever is applicable) of § 1.72-9 under the ages (as of the annuity starting date) and, if applicable, sexes of the annuitants. If, however, payments are to be made under the contract quarterly, semiannually, or annually, an appropriate adjustment of the multiple found in Table IIA or VIA shall be made in accordance with paragraph (a)(2) of this section.

(5) If a joint and survivor annuity contract involving two annuitants provides that a specified amount shall be paid during their joint lives and a different specified amount shall be paid to the survivor upon the death of whichever of the annuitants is the first to die, the following preliminary computation shall be made in all cases preparatory to determining the expected return under the contract:

(i) From Table II or VI (whichever is applicable), obtain the multiple under both of the annuitants' ages (as of the annuity starting date) and, if applicable, their appropriate sexes;

(ii) From Table IIA or VIA (whichever is applicable), obtain the multiple applicable to both annuitants' ages (as of the annuity starting date) and, if applicable, their appropriate sexes;

(iii) Apply the multiple found in subdivision (i) of this subparagraph to the total of the amounts to be received annually after the death of the first to die; and

(iv) Apply the multiple found in subdivision (ii) of this subparagraph to the difference between the total of the amounts to be received annually before and the total of the amounts to be received annually after the death of the first to die.

If the original annual payment is in excess of the annual payment to be made after the death of the first to die, the expected return is the sum of the amounts determined under subdivisions (iii) and (iv) of this subparagraph. This may be illustrated by the following examples:

Example (1). A husband purchases a joint and survivor annuity providing for payments of \$100 a month for as long as both he and his wife live, and, after the death of the first to die, payments to the survivor of \$75 a month for life. As of the annuity starting date, his age at his nearest birthday is 70 and that of his wife at her nearest birthday is 67. If there is no post-June 1986 investment in the contract, the expected return under the contract is computed as follows:

Multiple from Table II (male age 70, female age 67)	19.7
Multiple from Table IIA (male age 70, female age 67)	9.3
<hr/>	
Portion of expected return (\$900×19.7—sum per year after first death)	\$17,730
Plus: Portion of expected return (\$300×9.3—amount of change in sum at first death)	\$2,790
Expected return under the contract	\$20,520

The total expected return in this example, \$20,520, is to be used in computing the amount to be excluded from gross income. Thus, if the investment in the contract is \$17,887, the exclusion ratio is $\frac{\$17,887}{\$20,520}$, or 87.2 percent. The amount excludable from each monthly payment made while both are alive is 87.2 percent of \$100, or \$87.20, and the remaining \$12.80 of each payment shall be included in gross income. After the death of the first to die, the amount excludable by the survivor shall be 87.2 percent of each monthly payment of \$75, or \$65.40, and the remaining \$9.60 of each payment shall be included in gross income.

Example (2). Assume the same facts as in example (1), except that the contract is purchased after June 30, 1986.

The expected return under the contract is computed as follows:

Multiple from Table VI (ages 70, 67)	22.0
--	------

§ 1.72-5

Multiple from Table VIA (ages 70, 67)	12.4
<hr/>	
Portion of expected return (\$900×22.0—sum per year after first death)	\$19,800
Plus: Portion of expected return (\$300×12.4—amount of change in sum at first death)	\$3,720
<hr/>	
Expected return under the contract	\$23,520

Thus, if the investment in the contract is \$17,887, the exclusion ratio is $\$17,887 \div \$23,520$, or 76.1 percent. The amount excludable from each monthly payment made while both are alive would be 76.1 percent of \$100, or \$76.10, and the remaining \$23.90 of each payment would be included in gross income. After the death of the first to die, the amount excludable by the survivor would be 76.1 percent of each monthly payment of \$75, or \$57.08, and the remaining \$17.92 of each payment would be included in gross income.

Example (3). Assume the same facts as in examples (1) and (2), except that the total investment in the contract is \$17,887, and that the pre-July 1986 investment in the contract is \$8,000. Assume also that one of the annuitants makes the election described in § 1.72-6(d)(6). Separate computations shall be performed pursuant to § 1.72-6(d) to determine the amount excludable from gross income. The pre-July 1986 exclusion ratio would be $\$8,000 \div \$20,520$, or 39 percent. The post-June 1986 exclusion ratio would be $\$9,887 \div \$23,520$, or 42 percent. The amount excludable from each monthly payment made while both are alive would be \$81 $((.39 \times 100) + (.42 \times 100))$, and the remaining \$19 would be included in gross income. After the death of the first to die, the amount excludable by the survivor would be \$60.75 $((.39 \times 75) + (.42 \times 75))$, and the remaining \$14.25 would be included in gross income.

If the original annual payment is less than the annual payment to be made after the death of the first to die, the expected return is the difference between the amounts determined under subdivisions (iii) and (iv) of this subparagraph. If, however, payments are to be made quarterly, semiannually, or annually under the contract, the multiples obtained from both Tables II and IIA or Tables VI and VIA (whichever are applicable) shall first be adjusted in a manner prescribed in paragraph (a)(2) of this section.

(6) If a contract provides for the payment of life annuities to two persons during their respective lives and, after the death of one (without regard to which one dies first), provides that the

survivor shall receive for life both his own annuity payments and the payments made formerly to the deceased person, the expected return shall be determined in accordance with paragraph (e)(4) of this section.

(7) If paragraph (b)(3) of § 1.72-2 applies to payments provided under a contract and this paragraph applies to such payments, the principles of this paragraph shall be used in making the computations described in paragraph (d)(3) of § 1.72-4. This may be illustrated by the following examples, examples (1) through (3) of which assume that there is no post-June 1986 investment in the contract:

Example (1). Taxpayer A, a male age 63, pays \$24,000 for a contract which provides that the proceeds (both income and return of capital) from eight units of an investment fund shall be paid monthly to him for his life and that after his death the proceeds from six such units shall be paid monthly to B, a female age 55, for her life. The portion of the investment in the contract allocable to each taxable year of A is \$955.20 and that allocable to each taxable year of B is \$716.40. This is determined in the following manner:

Multiple from Table II (male, age 63, and female, age 55) ...	28.1
Number of units to be paid, in effect, as a joint and survivor annuity	×6
<hr/>	
Number of total annual unit payments anticipatable with respect to the joint and survivor annuity element	168.6
<hr/>	
Multiple from Table I (male, age 63)	16.2
Number of units to be paid, in effect, as a single life annuity	×2
<hr/>	
Number of total annual unit payments anticipatable with respect to A alone	32.4
<hr/>	
Total number of unit payments anticipatable	201
<hr/>	
Portion of investment in the contract allocable to unit payments (\$24,000÷201) on an annual basis	\$119.40
Number of units payable to A while he continues to live	×8
<hr/>	
Portion of the investment in the contract allocable to each taxable year of A	\$955.20

Internal Revenue Service, Treasury

§ 1.72-5

Portion of investment in the contract allocable to unit payments (\$24,000÷201) on an annual basis	\$119.40
Number of units payable to B for her life after A's death ...	×6
<hr/>	
Portion of the investment in the contract allocable to each taxable year of B	\$716.40

For the purpose of the above computation it is immaterial whether or not A lives to or beyond the life expectancy shown for him in Table I.

Example (2). Assume that Taxpayer A in example (1) receives payments for five years which are at least as large as the portion of the investment in the contract allocable to such years, but in the sixth year he receives a total of only \$626.40 rather than the \$955.20 allocable to such year. A is 69 and B is 61 at the beginning of the first monthly period for which an amount is payable in the seventh taxable year. A makes the election in that year provided under paragraph (d)(3) of § 1.72-4. The difference between the portion of the investment in the contract allocable to the sixth year and the amount actually received in that year is \$328.80 (\$955.20 less \$626.40). In this case, 139.2 unit payments are anticipatable (on an annual basis), since the appropriate multiple from Table II of § 1.72-9, 23.2, multiplied by the number of units payable, in effect, as a joint and survivor annuity yields this result (6×23.2). A's appropriate multiple from Table I of § 1.72-9 for the two units which will cease to be paid at his death is 12.6, and the total number of unit payments anticipatable (on an annual basis) is, therefore, 164.4 (2×12.6 plus 139.2). Dividing the difference previously found (\$328.80) by the total number of unit payments thus determined (164.4) indicates that A will have an additional allocation of the investment in the contract of \$16 to the seventh and every succeeding full taxable year (8 units×\$2), and B will have an additional allocation of the investment in the contract of \$12 (6 units×\$2) to each taxable year in which she receives 12 monthly payments subsequent to the death of A. The total allocable to each taxable year of A is, therefore, \$971.20, and that allocable to each taxable year of B will be \$728.40.

Example (3). If, in example (2), A had died at the end of the fifth year, in the sixth year B would have received a payment of \$469.80 (that portion of the \$626.40 that A would have received which is in the same ratio that 6 units bear to 8 units) and would thus have received \$246.60 less than the portion of the investment in the contract originally determined to be allocable to each of her taxable years. In these circumstances, B would be entitled to elect to redetermine the portion of the investment in the contract allocable to the taxable year of election and all subse-

quent years. The new amount allocable thereto would be found by dividing the \$246.60 difference by her life expectancy as of the first day of the first period for which she received an amount as an annuity in the seventh year of the annuity contract, and adding the result to her originally determined allocation of \$716.40.

Example (4). On July 1, 1986, Taxpayer C, age 60, pays \$28,000 for a contract which provides that the proceeds (both income and return of capital) from 10 units of an investment fund shall be paid monthly to C for C's life and that after C's death the proceeds from 4 such units shall be paid monthly to D, age 57, for D's life. The portion of the investment in the contract allocable to each taxable year of C is \$1,037.00 and that allocable to each taxable year of D is \$414.80. This is determined as follows:

Multiple from Table VI (ages 60, 57)	31.2
Number of units to be paid, in effect, as a joint and survivor annuity	×4
<hr/>	
Number of total annual unit payments anticipatable with respect to the joint and survivor annuity element	124.8
<hr/>	
Multiple from Table V (age 60)	24.2
Number of units to be paid, in effect, as a single life annuity	×6
<hr/>	
Number of total annual unit payments anticipatable with respect to C alone	145.2
<hr/>	
Total number of unit payments anticipatable	270
<hr/>	
Portion of investment in the contract allocable to unit payments (\$28,000÷270) on an annual basis	103.70
Number of units payable to C while C continues to live	×10
<hr/>	
Portion of the investment in the contract allocable to each taxable year of C	\$1,037.00
<hr/>	
Portion of investment in the contract allocable to unit payments (\$28,000÷270) on an annual basis	\$103.70
Number of units payable to D for D's life after C's death	×4
<hr/>	
Portion of the investment in the contract allocable to each taxable year of D	\$414.80

§ 1.72-5

26 CFR Ch. I (4-1-04 Edition)

For purposes of the above computation it is immaterial whether or not C lives to or beyond the life expectancy shown in Table V.

Example (5). Assume the same facts as in example (4), except that C's total investment in the contract is \$28,000, and C's pre-July 1986 investment in the contract is \$16,000. If C makes the election described in § 1.72-6(d)(6), separate computations are required to determine the amount excludable from gross income with respect to the pre-July 1986 investment in the contract and the post-June 1986 investment in the contract. The annuitant shall apply the appropriate pre-July 1986 and post-June 1986 life expectancy multiples to the applicable portions of the units to be paid as a joint and survivor annuity, and as a single life annuity.

Pre-July 1986 Computation (all references to unit payments are to the pre-July 1986 applicable portion of such payments):

Multiple from Table II (male, age 60, female, age 57)	27.6
Number of units to be paid, in effect, as a joint and survivor annuity	×4
<hr/>	
Number of total annual unit payments anticipatable with respect to the joint and survivor annuity element	110.40
<hr/>	
Multiple from Table I (male, age 60)	18.2
Number of units to be paid, in effect, as a single life annuity	×6
<hr/>	
Number of total annual unit payments anticipatable with respect to C alone	109.20
<hr/>	
Total number of unit payments anticipatable	219.6
<hr/>	
Portion of pre-July 1986 investment in the contract allocable to unit payments (\$16,000÷219.60) on an annual basis	\$72.86
<hr/>	
Number of units payable to C while C continues to live	×10
<hr/>	
Portion of pre-July 1986 investment in the contract allocable to each taxable year of C	728.60
<hr/>	
Portion of pre-July 1986 investment in the contract allocable to unit payments (\$16,000÷219.60) on an annual basis	72.86
Number of units payable to D for D's life after C's death	×4
<hr/>	

Portion of pre-July 1986 investment in the contract allocable to each taxable year of D	\$291.44
---	----------

Post-June 1986 Computation (all references to unit payments are to the post-June 1986 applicable portion of such payments):

Multiple from Table VI (ages 60, 57)	31.2
Number of units to be paid, in effect, as a joint and survivor annuity	×4
<hr/>	
Number of total annual unit payments anticipatable with respect to the joint and survivor annuity element	124.80
<hr/>	
Multiple from Table V (age 60)	24.2
Number of units to be paid, in effect, as a single life annuity	×6
<hr/>	
Number of total annual unit payments anticipatable with respect to C alone	145.20
<hr/>	
Total number of unit payments anticipatable	270
<hr/>	
Portion of post-June 1986 investment in the contract allocable to unit payments (\$12,000÷270) on an annual basis	\$44.44
Number of units payable to C while C continues to live	×10
<hr/>	
Portion of post-June 1986 investment in the contract allocable to each taxable year of C	\$444.40
<hr/>	
Portion of post-June 1986 investment in the contract allocable to unit payments (\$12,000÷270) on an annual basis	44.44
Number of units payable to D for D's life after C's death	×4
<hr/>	
Portion of post-June 1986 investment in the contract allocable to each taxable year of D	\$177.78
<hr/>	
Total computation:	
Total portion of the investment in the contract allocable to each taxable year of C (\$728.60+\$444.40)	\$1,173.00
Total portion of the investment in the contract allocable to each taxable year of D (\$291.44+\$177.78)	\$469.22

Example (6). Assume that taxpayer C in example (4) receives payments for four years which are at least as large as the portion of the investment in the contract allocable to such years, but in the fifth year receives a total of only \$600 rather than the \$1,037 allocable to such year. C is 65 and D is 62 at the beginning of the first monthly period for which an amount is payable in the sixth taxable year. C makes the election in that year provided under paragraph (d)(3) of § 1.72-4. The difference between the portion of the investment in the contract allocable to the fifth year and the amount actually received in that year is \$437 (\$1,037 - \$600). In this case, 106 unit payments are anticipatable with respect to the joint and survivor annuity element, since the appropriate multiple from Table VI of § 1.72-9, 26.5, multiplied by the number of units payable, in effect, as a joint and survivor annuity yields this result (4×26.0). C's appropriate multiple from Table V of § 1.72-9 for the six units which will cease to be paid at C's death is 20.0, and the number of unit payments anticipatable with respect to C alone is 120 (6×20). The total number of unit payments anticipatable is, therefore, 226 (120 plus 106). Dividing the difference previously found (\$437) by the total number of unit payments thus determined (226) indicates that C will have an additional allocation of the investment in the contract of \$19.30 to the sixth and every succeeding full taxable year ($10 \text{ units} \times \1.93), and D will have an additional allocation of the investment in the contract of \$7.72 ($4 \text{ units} \times \1.93) to each taxable year in which D receives 12 monthly payments subsequent to the death of C. The total allocable to each taxable year of C is, therefore, \$1,056.30, and that allocable to each taxable year of D will be \$422.52.

Example (7). If, in example (6), C had died at the end of the fourth year, in the fifth year D would have received a payment of \$240 (that portion of the \$600 that C would have received which is in the same ratio that 4 units bear to 10 units) and would thus have received \$174.80 less than the portion of the investment in the contract allocable to each of D's taxable years. In these circumstances, D would be entitled to elect to redetermine the portion of the investment in the contract allocable to the taxable year of election and all subsequent years. The new amount allocable thereto would be found by dividing the \$174.80 difference by D's life expectancy as of the first day of the first period for which D received an amount as an annuity in the sixth year of the annuity contract, and adding the result to D's originally determined allocation of \$414.80.

(c) *Expected return for term certain.* In the case of a contract providing for specific periodic payments which are to be paid for a term certain such as a fixed number of months or years, with-

out regard to life expectancy, the expected return is determined by multiplying the fixed number of years or months for which payments are to be made on or after the annuity starting date by the amount of the payment provided in the contract for each such period.

(d) *Expected return with respect to amount certain.* In the case of contracts involving no life or lives as a measurement of their duration, but under which a determinable total amount is to be paid in installments of lesser amounts paid at periodic intervals, the expected return shall be the total amount guaranteed. If an amount is to be paid periodically until a fund plus interest at a fixed rate is exhausted, but further payments may be made thereafter because of earnings at a higher interest rate, this paragraph shall apply to the total amount anticipatable as a result of the amount of the fund plus the fixed interest thereon. Any amount which may be paid as the result of earnings at a greater interest rate shall be disregarded in determining the expected return. If such an amount is later received, it shall be considered an amount not received as an annuity after the annuity starting date. See paragraph (b)(2) of § 1.72-11.

(e) *Expected return where two or more annuity elements providing for fixed payments are acquired for a single consideration.* (1) In the case of a contract described in paragraph (a)(2) of § 1.72-2, which provides for specified payments to be made under two or more annuity elements, the expected return shall be found for the contract as a whole by aggregating the expected returns found with respect to each annuity element. If individual life annuity elements are involved (including joint and survivor annuities where the primary annuitant died before January 1, 1954) the expected return for each of them shall be determined in the manner prescribed in paragraph (a) of this section. If joint and survivor annuity elements are involved, the expected return for such elements shall be determined under the appropriate subparagraph of paragraph (b) of this section. If terms certain or amounts certain are involved, the expected returns for such elements shall

§ 1.72-5

26 CFR Ch. I (4-1-04 Edition)

be determined under paragraph (c) or (d) of this section, respectively.

(2) The aggregate expected return found in accordance with the rules set forth in subparagraph (1) of this paragraph shall constitute the expected return for the contract as a whole. The investment in the contract shall be divided by the amount thus determined to obtain the exclusion ratio for the contract as a whole. This exclusion ratio shall be applied to all amounts received as an annuity under the contract by any recipient (in accordance with the provisions of §1.72-4), except in the case of amounts received by a surviving annuitant under a joint and survivor annuity element to which the provisions of section 72(i) and paragraph (b)(3) of this section would apply if it were a separate contract. See subparagraph (3) of this paragraph.

(3) In the case of a contract providing two or more annuity elements, one of which is a joint and survivor annuity element of the type described in section 72(i) and paragraph (b)(3) of this section, the general exclusion ratio for the contract as a whole, for the purpose of computations with respect to all the other annuity elements shall be determined in accordance with the principles of subparagraphs (1) and (2) of this paragraph. A special exclusion ratio shall thereafter be determined for the surviving annuitant receiving payments under the annuity element described in section 72(i) and paragraph (b)(3) of this section by using the investment in the contract and the expected return determined in accordance with the provisions of paragraph (b)(3) of this section.

(4) In the case of a contract providing for payments to be made to two persons in the manner described in paragraph (b)(6) of this section, the expected return is to be computed as though there were two joint and survivor annuities under the same contract, in the following manner. First, the multiple appropriate to the ages (as of the annuity starting date) and, if applicable, sexes of the annuitants involved shall be found in Table II or VI (whichever is applicable) of §1.72-9 and adjusted, if necessary, in the manner described in paragraph (a)(2) of this section. Second, the multiple so found

shall be applied to the sum of the payments to be made each year to both annuitants. The result is the expected return for the contract as a whole.

(5) For rules relating to expected return where two or more annuity elements are acquired for a single consideration and one or more of such elements does not specify a fixed payment for each period, see paragraph (f) of this section.

(f) *Expected return with respect to obligations providing for payments described in paragraph (b)(3) of §1.72-2.* (1) If a contract to which section 72 applies provides only for payments to be made in a manner described in paragraph (b)(3) of §1.72-2, the expected return for such contract as a whole shall be an amount equal to the investment in the contract found in accordance with section 72(c)(1) and §1.72-6, as adjusted for any refund feature in accordance with §1.72-7.

(2) If a contract to which section 72 applies provides for annuity elements, one or more of which (but not all) provide for payments to be made in a manner described in paragraph (b)(3) of §1.72-2:

(i) With respect to the portion of the contract providing for annuity elements to which paragraph (b)(3) of §1.72-2 does not apply, the expected return shall be the aggregate of the expected returns found for each of such elements in accordance with the appropriate paragraph of this section; and

(ii) With respect to all annuity elements to which paragraph (b)(3) of §1.72-2 does apply, the expected return for all such elements shall be an amount equal to the portion of the investment in the contract allocable to such elements in accordance with the provisions of paragraph (e)(2)(ii) of §1.72-4 and paragraph (b)(3)(ii)(b) of §1.72-6.

(g) *Expected return with respect to contracts subject to §1.72-6(d).* 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, an expected return is computed using the multiples in Tables I through IV of §1.72-9 with respect to the pre-July 1986 investment in the contract and a second expected return is computed using the multiples

in Tables V through VIII of § 1.72-9 with respect to the post-June 1986 investment in the contract.

[T.D. 6500, 25 FR 11402, Nov. 26, 1960; 25 FR 14021, Dec. 21, 1960, as amended by T.D. 8115, 51 FR 45694, Dec. 19, 1986]

§ 1.72-6 Investment in the contract.

(a) *General rule.* (1) For the purpose of computing the "investment in the contract", it is first necessary to determine the "aggregate amount of premiums or other consideration paid" for such contract. See section 72(c)(1). This determination is made as of the later of the annuity starting date of the contract or the date on which an amount is first received thereunder as an annuity. The amount so found is then reduced by the sum of the following amounts in order to find the investment in the contract:

(i) The total amount of any return of premiums or dividends received (including unrepaid loans or dividends applied against the principal or interest on such loans) on or before the date on which the foregoing determination is made, and

(ii) The total of any other amounts received with respect to the contract on or before such date which were excludable from the gross income of the recipient under the income tax law applicable at the time of receipt.

Amounts to which subdivision (ii) of this subparagraph applies shall include, for example, amounts considered to be return of premiums or other consideration paid under section 22(b)(2) of the Internal Revenue Code of 1939 and amounts considered to be an employer-provided death benefit under section 22(b)(1)(B) of such Code. For rules relating to the extent to which an employee or his beneficiary may include employer contributions in the aggregate amount of premiums or other consideration paid, see § 1.72-8. If the aggregate amount of premiums or other consideration paid for the contract includes amounts for which deductions were allowed under section 404 as contributions on behalf of a self-employed individual, such amounts shall not be included in the investment in the contract.

(2) For the purpose of subparagraph (1) of this paragraph, amounts received

subsequent to the receipt of an amount as an annuity or subsequent to the annuity starting date, whichever is the later, shall be disregarded. See, however, § 1.72-11.

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

Example (1). In 1950, B purchased an annuity contract for \$10,000 which was to provide him with an annuity of \$1,000 per year for life. He received \$1,000 in each of the years 1950, 1951, 1952, and 1953, prior to the annuity starting date (January 1, 1954). Under the Internal Revenue Code of 1939, \$300 of each of these payments (3 percent of \$10,000) was includible in his gross income, and the remaining \$700 was excludable therefrom during each of the taxable years mentioned. In computing B's investment in the contract as of January 1, 1954, the total amount excludable from his gross income during the years 1950 through 1953 (\$2,800) must be subtracted from the consideration paid (\$10,000). Accordingly, B's investment in the contract as of January 1, 1954, is \$7,200 (\$10,000 less \$2,800).

Example (2). In 1945, C contracted for an annuity to be paid to him beginning December 31, 1960. In 1945 and in each successive year until 1960, he paid a premium of \$5,000. Assuming he receives no payments of any kind under the contract until the date on which he receives the first annual payment as an annuity (December 31, 1960), his investment in the contract as of the annuity starting date (December 31, 1959) will be \$75,000 (\$5,000 paid each year for the 15 years from 1945 to 1959, inclusive).

Example (3). Assume the same facts as in example (2), except that prior to the annuity starting date C has already received from the insurer dividends of \$1,000 each in 1949, 1954, and 1959, such dividends not being includible in his gross income in any of those years. C's investment in the contract, as of the annuity starting date, will then be \$72,000 (\$75,000-\$3,000).

(b) *Allocation of the investment in the contract where two or more annuity elements are acquired for a single consideration.* (1) In the case of a contract described in § 1.72-2(a)(2) which provides for two or more annuity elements, the investment in the contract determined under paragraph (a) shall be allocated to each of the annuity elements in the ratio that the expected return under each annuity element bears to the aggregate of the expected returns under all the annuity elements. The exclusion ratio for the contract as a whole