Revenue Ruling 67-336
Internal Revenue Service
1967-2 C.B. 66

SECTION 72.-ANNUITIES; CERTAIN PROCEEDS OF ENDOWMENT AND LIFE INSURANCE CONTRACTS

26 CFR 1.72-8: Effect of certain employer contributions with respect to premiums or other consideration paid or contributed by an employee.

Rev. Rul. 67-336

The trustee of an exempt employees' trust surrendered a life insurance contract and used the proceeds to purchase an annuity contract upon retirement of a participating employee. The employee's consideration for the annuity contract within the meaning of section 72 of the Internal Revenue Code of 1954 does not encompass that portion of the premiums included in his gross income while the surrendered policy was outstanding because it was paid for life insurance protection under that policy.

Advice has been requested concerning the employee's consideration for an annuity contract, within the meaning of section 72 of the Internal Revenue Code of 1954, under the circumstances described below.

An employer established a trust, forming part of an employees' pension plan described in section 401(a) of the Code, which was exempt from tax under section 501(a) of the Code, and paid the entire cost of benefits provided by the trust pursuant to the plan. Under the plan, participants' lives were insured during employment by life insurance policies purchased by the trustee.

The trust maintained separate accounts for participants known as the insurance account and the investment account. Amounts allocated to the insurance account were used to pay the premiums on the life insurance policies. The net term cost of current life insurance protection was included annually in the gross income of each participant under section 72(m)(3) of the Code. See section **1.72-16**(b) of the Income Tax Regulations.

On or before the participant's retirement date the trustee surrendered the life insurance policy on the participant's life for its cash value. Thereafter, an amount comprised of the cash received upon the surrender of the insurance contract together with additional monies from the investment account was used by the trustee to purchase for the participant a single premium annuity contract providing the retirement benefits specified in the plan. The specific question is whether under these circumstances the employee's consideration for the annuity contract encompasses that portion of the premiums included in his gross income while the surrendered policy was outstanding.

Section 72(m)(3) of the Code provides that any contribution to a trust described in section 401(a) and exempt from tax under section 501(a) of the Code, and any income of such trust, which has been used to purchase life insurance protection where the proceeds of such contract are payable directly or indirectly to a participant in such trust or to a beneficiary of such participant, is includible in the gross income of the participant for the taxable year when so applied.

Section 1.72-8(a)(-1) of the regulations provides that for purposes of determining an employee's investment in an annuity contract, amounts contributed by an employer for the benefit of an employee or his beneficiaries shall constitute consideration paid or contributed by the employee for the contract to the extent that such amounts were includible in the gross income of the employee under subtitle A of the Code or prior income tax laws.

Section **1.72-16**(b)(4) of the regulations, dealing with treatment of the cost of life insurance protection, however, provides that the amount includible in the gross income of the employee under this paragraph shall be considered as premiums or other consideration paid or contributed by the employee only with respect to any benefits attributable to the contract (within the meaning of section 1.72-2(a)(3) of the regulations dealing with separate programs consisting of interrelated contributions or benefits being treated as a single contract) providing the life insurance protection.

In the instant case, the contract providing life insurance protection consisted of a policy which provided such protection for the plan participant prior to retirement, but it was surrendered to the insurer by the trustee for its cash value. Subsequently the proceeds of the policy together with additional monies from the investment account were used by the trustee to purchase an entirely new contract, i.e., a single premium annuity contract under which payments equal to the amount of retirement benefits specified under the plan become payable to the participant upon his retirement.

The only benefits payable under the plan are those provided under the annuity contract. Hence, the retirement benefits are considered received under a single contract within the purview of section 1.72-2(a)(3) of the regulations.

Accordingly, the employee's consideration for the annuity contract within the meaning of section 72 of the Code, which contract was purchased by the trustee of the exempt employees' trust with the proceeds of the surrendered life insurance policy, does not encompass that portion of the premiums included in the employee's gross income because it was paid for life insurance protection under the surrendered policy.