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Internal Revenue Code Section 72(e)(10)(A)(i)

Annuities; certain proceeds of endowment and life insurance contracts

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(e) Amounts not received as annuities.

(1) Application of subsection.

(A) In general. This subsection shall apply to any amount which-

(i) is received under an annuity, endowment, or life insurance contract,
and

(ii) is not received as an annuity,

if no provision of this subtitle (other than this subsection) applies with respect to such amount.

(B) Dividends. For purposes of this section , any amount received which is in the nature of a dividend or similar distribution shall be treated as an amount not received as an annuity.

(2) General rule.

Any amount to which this subsection applies-

(A) if received on or after the annuity starting date, shall be included in gross income, or

(B) if received before the annuity starting date-

(i) shall be included in gross income to the extent allocable to income on the contract, and

(ii) shall not be included in gross income to the extent allocable to the investment in the contract.

(3) Allocation of amounts to income and investment.

For purposes of paragraph (2)(B) -

(A) Allocation to income. Any amount to which this subsection applies shall be treated as allocable to income on the contract to the extent that such amount does not exceed the excess (if any) of-

(i) the cash value of the contract (determined without regard to any surrender charge) immediately before the amount is received, over

(ii) the investment in the contract at such time.

(B) Allocation to investment. Any amount to which this subsection applies shall be treated as allocable to investment in the contract to the extent that such amount is not allocated to income under subparagraph (A) .

(4) Special rules for application of paragraph (2)(B) .

For purposes of paragraph (2)(B) -

(A) Loans treated as distributions. If, during any taxable year, an individual-

(i) receives (directly or indirectly) any amount as a loan under any contract to which this subsection applies, or

(ii) assigns or pledges (or agrees to assign or pledge) any portion of the value of any such contract,

such amount or portion shall be treated as received under the contract as an amount not received as an annuity. The preceding sentence shall not apply for purposes of determining investment in the contract, except that the investment in the contract shall be increased by any amount included in gross income by reason of the amount treated as received under the preceding sentence.

(B) Treatment of policyholder dividends. Any amount described in paragraph (1)(B) shall not be included in gross income under paragraph (2)(B)(i) to the extent such amount is retained by the insurer as a premium or other consideration paid for the contract.

(C) Treatment of transfers without adequate consideration.

(i) In general. If an individual who holds an annuity contract transfers it without full and adequate consideration, such individual shall be treated as receiving an amount equal to the excess of-

(I) the cash surrender value of such contract at the time of transfer, over

(II) the investment in such contract at such time,

under the contract as an amount not received as an annuity.

(ii) Exception for certain transfers between spouses or former spouses. Clause (i) shall not apply to any transfer to which section 1041(a) (relating to transfers of property between spouses or incident to divorce) applies.

(iii) Adjustment to investment in contract of transferee. If under clause (i) an amount is included in the gross income of the transferor of an annuity contract, the investment in the contract of the transferee in such contract shall be increased by the amount so included.

(5) Retention of existing rules in certain cases.

(A) In general. In any case to which this paragraph applies-

(i) paragraphs (2)(B) and (4)(A) shall not apply, and

(ii) if paragraph (2)(A) does not apply,

the amount shall be included in gross income, but only to the extent it exceeds the investment in the contract.

(B) Existing contracts. This paragraph shall apply to contracts entered into before August 14, 1982. Any amount allocable to investment in the contract after August 13, 1982, shall be treated as from a contract entered into after such date.

(C) Certain life insurance and endowment contracts. Except as provided in paragraph (10) and except to the extent prescribed by the Secretary by regulations, this paragraph shall apply to any amount not received as an annuity which is received under a life insurance or endowment contract.

(D) Contracts under qualified plans. Except as provided in paragraph (8) , this paragraph shall apply to any amount received-

(i) from a trust described in section 401(a) which is exempt from tax under section 501(a) ,

(ii) from a contract-

(I) purchased by a trust described in clause (i) ,

(II) purchased as part of a plan described in section 403(a) ,

(III) described in section 403(b) , or

(IV) provided for employees of a life insurance company under a plan described in section 818(a)(3) , or

(iii) from an individual retirement account or an individual retirement annuity.

Any dividend described in section 404(k) which is received by a participant or beneficiary shall, for purposes of this subparagraph , be treated as paid under a separate contract to which clause (ii)(I) applies.

(E) Full refunds, surrenders, redemptions, and maturities. This paragraph shall apply to-

(i) any amount received, whether in a single sum or otherwise, under a contract in full discharge of the obligation under the contract which is in the nature of a refund of the consideration paid for the contract, and

(ii) any amount received under a contract on its complete surrender, redemption, or maturity.

In the case of any amount to which the preceding sentence applies, the rule of paragraph (2)(A) shall not apply.

(6) Investment in the contract.

For purposes of this subsection , the investment in the contract as of any date is-

(A) the aggregate amount of premiums or other consideration paid for the contract before such date, minus

(B) the aggregate amount received under the contract before such date, to the extent that such amount was excludable from gross income under this subtitle or prior income tax laws.

(7) Repealed.

(8) Extension of paragraph (2)(B) to qualified plans.

(A) In general. Notwithstanding any other provision of this subsection , in the case of any amount received before the annuity starting date from a trust or contract described in paragraph (5)(D) , paragraph (2)(B) shall apply to such amounts.

(B) Allocation of amount received. For purposes of paragraph (2)(B) , the amount allocated to the investment in the contract shall be the portion of the amount described in subparagraph (A) which bears the same ratio to such amount as the investment in the contract bears to the account balance. The determination under the preceding sentence shall be made as of the time of the distribution or at such other time as the Secretary may prescribe.

(C) Treatment of forfeitable rights. If an employee does not have a nonforfeitable right to any amount under any trust or contract to which subparagraph (A) applies, such amount shall not be treated as part of the account balance.

(D) Investment in the contract before 1987. In the case of a plan which on May 5, 1986, permitted withdrawal of any employee contributions before separation from service, subparagraph (A) shall apply only to the extent that amounts received before the annuity starting date (when increased by amounts previously received under the contract after December 31, 1986) exceed the investment in the contract as of December 31, 1986.

(9) Extension of paragraph (2)(B) to qualified tuition programs and Coverdell education savings accounts.

Notwithstanding any other provision of this subsection , paragraph (2)(B) shall apply to amounts received under a qualified tuition program (as defined in section 529(b)) or under a Coverdell education savings account (as defined in section 530(b)). The rule of paragraph (8)(B) shall apply for purposes of this paragraph .

(10) Treatment of modified endowment contracts.

(A) In general. Notwithstanding paragraph (5)(C) , in the case of any modified endowment contract (as defined in section 7702A)-

(i) paragraphs (2)(B) and (4)(A) shall apply, and

(ii) in applying paragraph (4)(A) , "any person" shall be substituted for "an individual".



(B) Treatment of certain burial contracts. Notwithstanding subparagraph (A) , paragraph (4)(A) shall not apply to any assignment (or pledge) of a modified endowment contract if such assignment (or pledge) is solely to cover the payment of expenses referred to in section 7702(e)(2)(C)(iii) and if the maximum death benefit under such contract does not exceed \$25,000.

(11) Special rules for certain combination contracts providing long-term care insurance. Notwithstanding paragraphs (2) , (5)(C) , and (10) , in the case of any charge against the cash value of an annuity contract or the cash surrender value of a life insurance contract made as payment for coverage under a qualified long-term care insurance contract which is part of or a rider on such annuity or life insurance contract-

(A) the investment in the contract shall be reduced (but not below zero) by such charge, and

(B) such charge shall not be includible in gross income.

(12) Anti-abuse rules.

(A) In general. For purposes of determining the amount includible in gross income under this subsection -

(i) all modified endowment contracts issued by the same company to the same policyholder during any calendar year shall be treated as 1 modified endowment contract, and

(ii) all annuity contracts issued by the same company to the same policyholder during any calendar year shall be treated as 1 annuity contract.

The preceding sentence shall not apply to any contract described in paragraph (5)(D) .

(B) Regulatory authority. The Secretary may by regulations prescribe such additional rules as may be necessary or appropriate to prevent avoidance of the purposes of this subsection through serial purchases of contracts or otherwise.

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