

Part III

Administrative, Procedural, and Miscellaneous

26 CFR 601.105: Examination of returns and claims for refund, credit or abatement; determination of correct tax liability.

(Also Part I, Sections 72; 1.72–2, 1.72–4.)

Rev. Proc. 2016–36

SECTION 1. PURPOSE

This revenue procedure provides guidance regarding the application of §§ 1.72-2(b)(2) and 1.72-4(b)(1) of the Income Tax Regulations to amounts to which § 72 of the Internal Revenue Code applies that are received from a non-qualified contract. This revenue procedure does not apply to amounts to which § 72 applies that are received under a qualified plan as described in § 72(e)(5)(D). See Notice 2016-39, 2016-26 I.R.B. __ (June 27, 2016).

SECTION 2. BACKGROUND

.01 In general, § 72 provides that distributions from an annuity, endowment, or life insurance contract are includible in gross income except to the extent the distribution is a non-taxable return of investment. For purposes of determining the extent to which a distribution is a non-taxable return of investment, § 72 distinguishes between an “amount received as an annuity” and an “amount not received as an annuity.”

.02 Notice 2016-39 concludes that periodic phased retirement benefits under a qualified defined benefit plan do not qualify as “amounts received as an annuity” for purposes of § 72 if all the following conditions apply:

(1) The employee begins to receive a portion of his or her retirement benefits when he or she enters phased retirement and begins part-time employment, and will not begin receiving his or her entire plan benefits until he or she ceases employment and commences full retirement at an indeterminate future time (for this purpose, even if a full retirement date is agreed upon at commencement of phased retirement, the employee’s date of full retirement is indeterminate as long as it is possible that date could change);

(2) The plan’s obligations to the employee are based in part on the employee’s continued part-time employment (which affects both the duration of the payment of phased retirement benefits and the amount of additional retirement benefits the employee accrues during that period of part-time employment); and

(3) Under the plan terms, the employee does not have an election as to the form of the phased retirement benefit to be paid during phased retirement, but elects a distribution option at full retirement that applies to the employee’s entire retirement benefit, including the portion that commenced as phased retirement benefits.

.03 Notice 2016-39 provides that because the benefits are amounts not received as an annuity that are paid under a qualified defined benefit plan, the employee recovers investment in the contract under the rules in § 72(e)(8).

SECTION 3. APPLICATION

.01 Section 72 differentiates between amounts received from qualified plans and amounts received from non-qualified contracts. In particular, the treatment of amounts that are not received as an annuity differs substantially depending on whether the amount is received from a qualified plan or a non-qualified contract.

.02 Section 72(b)(1) provides that gross income does not include that part of any amount received as an annuity under an annuity, endowment, or life insurance contract that bears the same ratio to that amount as the investment in the contract (as of the annuity starting date) bears to the expected return under the contract. For purposes of § 72(b), the investment in the contract as of the annuity starting date is (1) the aggregate amount of premiums or other consideration paid for the contract, minus (2) the aggregate amount received under the contract before such date, to the extent that such amount was excludable from gross income. Section 72(c).

.03 Section 72(b), however, does not apply in the case of any amount received as an annuity under a qualified employer retirement plan described in § 72(d)(1)(G) (which includes a qualified defined benefit plan described in § 401(a)). Instead, the investment in the contract is recovered under the simplified method of § 72(d)(1). Under this method, gross income excludes the portion of a monthly annuity that does not exceed the amount obtained by dividing (1) the investment in the contract by (2) the number of anticipated payments determined under the table in § 72(d)(1)(B)(iii).

.04 Section 72(e) applies to any amount that is received under an annuity, endowment, or life insurance contract and is not received as an annuity. Section

72(e)(2)(B) provides that if an amount to which § 72(e) applies is received before the annuity starting date, it is included in gross income to the extent allocable to income on the contract and is excluded from gross income to the extent allocable to the investment in the contract. Section 72(e)(3)(A) provides that for purposes of section 72(e)(2)(B) an amount is treated as allocable to income on the contract to the extent such amount does not exceed the excess (if any) of the cash value of the contract (determined without regard to any surrender charge) immediately before the amount is received over the investment in the contract at such time.

.05 Section 72(e)(8), however, provides special rules for amounts not received as an annuity from a trust or contract described in § 72(e)(5)(D) (which includes a qualified defined benefit plan described in § 401(a)). Under § 72(e)(8)(B) and (C), the amount allocated to the investment in the contract is the portion of the distribution that bears the same ratio to the amount of the distribution as the investment in the contract bears to the vested account balance. Section 72(e)(8)(B) provides that this determination is made at the time of the distribution or at a time prescribed by the Secretary.

.06 The Internal Revenue Service will not apply Notice 2016-39 to amounts received from a non-qualified contract. Accordingly, in applying §§ 1.72-2(b)(2) and 1.72-4(b)(1) to a non-qualified contract, the possibility of further contributions to the contract or a subsequent election under the contract to receive the benefit payable under the contract in a different manner generally will not affect the determination of whether payments are amounts received as an annuity.

SECTION 4. EFFECTIVE DATE

This revenue procedure applies to taxable years beginning on or after January 1, 2016. Taxpayers, however, may apply this revenue procedure to taxable years beginning before that date. This revenue procedure does not apply to amounts to which § 72 applies that are received under a qualified plan as described in § 72(e)(5)(D). See Notice 2016-39.

SECTION 5. DRAFTING INFORMATION

The principal author of this revenue procedure is Alexis A. MacIvor of the Office of Assistant Chief Counsel (Financial Institutions and Products). For further information regarding this revenue procedure, contact Ms. MacIvor at 202-317-6995 (not a toll-free call).