

TAX TREATMENT OF CERTAIN AMOUNTS PAID TO CERTAIN MEMBERS AND FORMER MEMBERS OF UNIFORMED SERVICES AND TO THEIR SURVIVORS

FEBRUARY 16, 1966.—Ordered to be printed

Mr. LONG of Louisiana, from the Committee on Finance, submitted the following

REPORT

[To accompany H. R. 10625]

The Committee on Finance, to which was referred the bill (H. R. 10625) relating to the tax treatment of certain amounts paid to certain members and former members of the uniformed services and to their survivors, having considered the same, reports favorably thereon without amendment and recommends that the bill do pass.

I. SUMMARY

This bill, as passed by the House and agreed to by the Committee on Finance, makes a series of amendments to the Internal Revenue Code designed to provide essentially the same tax treatment under the retired serviceman's family protection plan where provision is made for annuities for surviving spouses or certain child beneficiaries as already is provided in the case of the civil service retirement program and other qualified pension plans. Thus where reduced retirement pay is accepted by servicemen (or former servicemen) in order to provide annuities for their survivors, the amount of the reduction will no longer be taxed to the retired servicemen and such reductions which have been included in retired servicemen's retirement income in the past may be offset against otherwise taxable retirement pay in the future. The exclusion of up to \$5,000 paid to a survivor of a decedent which is available where an employer makes the payment to a beneficiary on account of the death of an employee also is to be available to survivors of deceased servicemen who retired because of disability and died before attaining normal retirement age. In addition the estate and gift tax exclusions available under present law for the value of survivor annuities in the case of civil service annuities and those under other qualified pension plans are also to be made avail-

2 TAX TREATMENT—CERTAIN MEMBERS OF UNIFORMED SERVICES

able in the case of annuities provided for survivors under the retired serviceman's family protection plan.

The income tax amendments generally apply to taxable years ending after December 31, 1965, or in the case of the death benefit exclusion to those who die after that date. The estate tax amendment applies to decedents dying after December 31, 1965, and the gift tax amendments to gifts made after the calendar year 1965.

The bill is favored by both the Treasury Department and the Defense Department.

II. REASONS FOR THE BILL

Under present law, a member of the armed or other uniformed services may elect to receive a reduced amount of retired or retainer pay during his lifetime in order to provide an annuity for his surviving spouse or certain child beneficiaries. Provision is made for this under the retired serviceman's family protection plan (10 U.S.C. 1431 et seq.).

Under present law, generally, when an individual receives a pension or annuity which has been wholly provided by his employer, he is taxed on the payments when received as ordinary income.¹ In addition, under present law, when an individual elects to receive a reduced pension in order to provide an annuity for his survivor, in lieu of a single pension, unless he is covered by a qualified pension or annuity plan, he generally is treated as if he still received the single pension, and is taxed on the full amount he would have received had he not elected to receive the lesser amount. This treatment prevails for such a nonqualified pension and annuity because the retiree had the option to receive the greater amount. By electing to receive the reduced amount, he is considered, in effect, to have constructively received each larger pension payment and to have exchanged part of each of these payments for the annuity for his survivor. In this case, therefore, upon the death of the retiree, his survivor is treated as having an investment in the annuity she then receives in an amount equal to the reduction in the retiree's pension on which he paid tax up to the time of his death. This amount is treated as the survivor's "consideration" for the annuity and she is permitted to recover it tax free over her life expectancy.

In the case of qualified pension plans, a different treatment is provided for elections of these survivor annuities. Instead of treating an election to take such an annuity to be an exchange of a portion of single pension for the survivor annuity (and, therefore, taxable to the extent of the exchange), the survivor annuity is treated as a mere continuation of the initial pension. It follows from this treatment that upon the death of the retiree, the survivor is treated as having no "consideration" for the survivor annuity by reason of the election and, therefore, she has no tax-free recovery (on this account) over her life expectancy. As a result, in the case of qualified pensions and annuities where the employee made no contributions, the entire amount of the payments actually received by the retiree and his survivor are subject to tax as received. However, the retiree is not taxed on any additional amount over and above the amount

¹ In the case of contributory pensions or annuities, a portion of the pension or annuity payments determined on the basis of the total of the contributions is free of tax. This entire amount, called the investment in the contract, may be returned in the first 3 years or over the life expectancy of the annuitant.

actually received (that is, the reduction in his single pension because of the election of the survivor feature).

Among the requirements to obtain qualified status and, therefore, to be eligible for this treatment of survivor annuities are requirements that the plan be nondiscriminatory and that it be funded. The retired serviceman's family protection plan meets the nondiscriminatory tests but is not a qualified plan under present law because it is not funded. In this respect it differs from the civil service retirement program (5 U.S.C. 2251 et seq.), which has been classified as a funded plan and, therefore, does qualify for the survivor annuity tax treatment outlined here.

In addition to the generally more favorable income tax treatment received by qualified pension or annuity plans with respect to the survivor feature, these qualified plans also receive other tax advantages under present law. In the case of the estate tax, for example, the value of annuities to be received under qualified plans (to the extent not contributed by the employee) passing to a survivor are excluded from the gross estate and, therefore, not subject to estate tax. In the case of nonqualified plans, generally this value is included in the estate tax base.

In addition, in the case of qualified pensions and annuities (to the extent not contributed by the employee), the exercise (or failure to exercise) by an employee of an election to take a survivor annuity in place of part of a single pension is not considered a taxable gift by the retiree. The contrary is generally true in the case of nonqualified plans.

A third advantage in having a qualified pension plan is that in the case of these plans an exclusion of up to \$5,000 is available to the survivor where the retiree dies before retirement age. This is an exclusion for income tax purposes.

Your committee agrees with the Committee on Ways and Means of the House that members (or former members) of the uniformed services should be treated essentially the same as retirees under the civil service program and under other qualified pension or annuity plans. There is no substantial grounds for distinguishing the tax treatment of the plan for the uniformed services from these other plans. Although qualified plans are required to be funded in order to give assurance that the money intended for payment of the retirement benefits is actually available to pay the benefits when needed, the obligation of the United States to pay benefits under the retired serviceman's family protection plan is a sufficient guarantee that these amounts will be paid when due. As a result, your committee has concluded that these uniformed services retirees should be treated in the same manner as pensioners under qualified plans. In doing this, however, it is not intended to extend any advantages to the uniformed services personnel not available to civil service retirees. Thus, although survivor annuities are considered under this provision to be a continuation of the initial single pension for purposes of reducing the taxable portion of the retiree, it is not intended that any benefit the retiree receives on account of disability be carried over and applied in the case of the survivor. Such an exclusion is not available at present for the survivors of uniformed services retirees or in the case of civil service retirees, and it is not intended by this action that any such benefit be extended.

III. GENERAL EXPLANATION

Income tax treatment of election of annuity for survivor

The bill first deals with the income tax treatment of the uniformed services personnel who elect to take a reduced amount of retirement pay in order to obtain an annuity for their surviving spouse or other beneficiary.

The bill provides as a general rule (new sec. 122(a) of the code) that members, or former members, of the uniformed services of the United States who make or have made an election under the retired serviceman's family protection plan (ch. 73, title 10, U.S.C.) to receive a reduced amount of retirement pay (or retainer pay) are to exclude from their gross income for tax purposes any reduction in their retirement pay (or retainer pay) resulting from this election. This rule applies to reductions in retirement pay after December 31, 1965.

Thus, where a serviceman who was eligible to receive retirement pay of \$500 a month elects to receive, perhaps, \$400 a month instead in order to obtain for his wife an annuity of \$200 a month upon his death, he will (insofar as retirement pay received in the future is concerned) report \$400 a month for tax purposes during his lifetime, rather than the \$500 required by present law. Upon his death his wife generally will report the full \$200 a month she receives as income," instead of some lesser amount determined by treating as "consideration" the additional amounts (\$100 a month for the period up to the husband's death) on which tax was paid under present law (but not under the bill) by her husband and spreading this exclusion over the period of her life expectancy. This new rule applies for any reduced amount received after December 31, 1965.

The bill also provides a special rule (sec. 122(b) of the code), designed in part as a transitional rule, to provide for those cases where a retired serviceman has already included in his income subject to tax more retirement pay than he has actually received. In such cases his retirement income is excluded from tax in 1966 and subsequent years until the amount so excluded equals this excess amount previously included in gross income. In other words, to continue the case presented above, assume that prior to January 1, 1966, the serviceman had already been retired for a period of 5 years and reported for tax purposes in this 60-month period an aggregate of \$30,000 of income ($\500×60), whereas he actually received only \$24,000 ($\400×60) in this period. In this case, he would be treated as having \$6,000 as his "consideration for the contract." This consideration for the contract is then excluded under the bill from all retirement pay received after December 31, 1965, until the amount so excluded equals the "consideration for the contract." Thereafter, all retirement pay is included in gross income.

This special rule will also cover cases where a serviceman after retirement elects to receive veterans' benefits in lieu of some or all of his retirement pay. In such cases he may be required to pay to the U.S. Treasury an amount equal to the reduction in his retired pay resulting from electing the survivor's annuity. These deposits are made pursuant to section 1438 of title 10 of the United States Code and are treated as "consideration for the contract." Under the bill these amounts are recoverable in full on a tax-free basis from retirement pay before any of this pay is includible in gross income.

Another amendment (adding sec. 72(o) to the code) provides for the case where all of the consideration for the contract has not been offset against his retirement income at the time of the death of the retiree. Thus this amendment provides for the exclusion from gross income of all the payments received by the survivor until the amount so excluded equals any remaining "consideration for the contract" not previously excluded from gross income by the retiree (under sec. 122(b)) or previously excluded from gross income (prior to 1966) by the survivor under section 72(b). Amounts received thereafter by the survivor are, of course, included in her income subject to tax. For both the retiree and his survivor this provision, together with the provision described above, provides for the full recovery of the consideration for the contract from the retirement pay (or from the survivor's annuity to the extent necessary) without regard to the life expectancy of the retiree or his survivor and without regard to whether or not this full amount may be recovered in the first 3 years of the survivor's annuity.

The application of new section 72(o) may be illustrated by the following example: Assume that a serviceman who was eligible to receive retired pay of \$500 a month elected to receive reduced retired pay of \$400 a month in order to provide an annuity for his wife of \$200 a month upon his death, and that the serviceman received payments of \$400 for 40 months before January 1, 1966. Assume further that no part of his retired pay is excludable from gross income by reason of disability or otherwise and that after attaining retirement age he dies on March 1, 1966, after receiving his retired pay of \$400 for the months of January and February 1966. Under section 72(o) the widow will exclude the monthly payments she receives until she has excluded \$3,200, since the consideration for the contract was \$4,000 (40 times \$100) and her husband was permitted to exclude under section 122(b) the two payments of \$400 he received in January and February 1966, leaving \$3,200 to be recovered tax free by his widow.

If the serviceman had died on July 1, 1965, after having received monthly payments of \$400 for 34 months, the consideration for the contract would have been \$3,400. Under section 72(o) the widow would be entitled to recover tax free the \$3,400 less the amount she was entitled to exclude under section 72(b) of existing law with respect to the six monthly payments of \$200 she received in the last 6 months of 1965 after her husband's death. Assume that by reason of the exclusion ratio under section 72(b) she was entitled to exclude \$1,000 of the \$1,200 she received in 1965, then beginning with the January 1966 payment she would be entitled to exclude the entire amount of 12 payments (\$2,400) and thereafter she would include in gross income the entire amount of each monthly payment.

In determining whether there has been a recovery of the "consideration for the contract" by the retiree under section 122(b), there is not to be taken into account amounts which may be excluded from gross income under sections 104(a)(4) and 105(d) of the code. These exclusions granted the retiree because of disability or sickness do not carry over to the surviving spouse since these exclusions are personally related to the retiree alone.

In cases where an individual whose name is removed from the temporary disability list receives a refund of an amount deducted from his retired pay, which was withheld while he was on the dis-

6 TAX TREATMENT—CERTAIN MEMBERS OF UNIFORMED SERVICES

ability list to provide the survivor annuity (10 U.S.C. 1439), it is intended that, for taxable years beginning after December 31, 1965, he will be able to exclude from gross income that portion of the refunded amount which he would have been able to exclude if he had received the total amount of his retirement pay during the period he was on the temporary disability retired list.

Income tax exclusion for survivor, \$5,000

The final income tax amendment made by the bill adds a new sentence to a provision in the code, relating to employee death benefits (sec. 101(b)(2)(D)).

Under present law, where the serviceman dies before retirement age but after having elected upon retirement for disability an annuity for his surviving spouse or certain other beneficiaries, the exclusion of up to \$5,000 paid by an employer by reason of the death of the employee is not available because the annuity for the survivor is considered as having been purchased by the "employee" rather than provided by the "employer." Because of the change made by this bill in the treatment of annuities for survivors in the case of servicemen, the annuity for the survivor no longer is considered as being purchased by the "employee." Therefore, the annuity of the survivor under this bill is treated as having been paid by the employer by reason of the death of the employee and in certain cases is eligible for the \$5,000 income tax exclusion for the survivor.

The new sentence added to the employee death benefit provision (sec. 101(b)(2)(D)) by this bill provides that the death benefit exclusion is not to be available in the case of an annuity paid under the retired serviceman's family protection plan if the individual who made the election under the plan died after attaining retirement age. Thus the exclusion in practice will be available only where the serviceman retired before normal retirement age because of disability and dies before attaining such age.

As in the case of other annuities the survivor's annuity provided under this bill for purposes of the \$5,000 exclusion is to be valued on the date the former serviceman died (see first sentence of sec. 101(b)(2)(D)). Also, any amount excluded under the death benefit provision is, for the purposes of determining how much of the annuity is to be taxed, to be treated as additional consideration for the contract. (This is provided both by the second sentence of sec. 101(b)(2)(D) and also by the amendment adding sec. 72(o).)

The treatment described above will accord survivors under the retired serviceman's family protection plan the same treatment as survivors under the civil service retirement program (5 U.S.C. 2251 et seq.).

Income tax effective dates

The provision relating to employee death benefits applies with respect to individuals making the election with respect to an annuity for a survivor under chapter 73 of title 10 of the United States Code who die after December 31, 1965. The other income tax amendments apply with respect to taxable years ending after December 31, 1965.

Estate tax exclusion

The bill amends the estate tax provisions of the code (sec. 2039(c)(4)) to exclude from the gross estate on which the Federal death tax is levied the value of an annuity paid under the retired serviceman's

family protection plan. This exclusion, however, does not apply to the extent any of the value of the annuity for the survivor is attributable to deposits (made pursuant to sec. 1438 of title 10) made by the deceased serviceman. This is the same treatment as provided under present law in the case of the civil service retirement program and other qualified pension plans.

Gift tax exclusion

The bill also amends the gift tax provisions (sec. 2517(a)(4)) to provide that the exercise, or nonexercise, by an employee of an election to provide an annuity for a survivor in lieu of a single pension is not to be considered a taxable transfer for gift tax purposes if made under the retired serviceman's family protection plan. This is the same treatment already available in the case of the civil service retirement program and other qualified pension plans.

Estate and gift tax effective dates

The estate tax amendment referred to above applies with respect to decedents dying after December 31, 1965, and the gift tax amendment applies with respect to calendar years after 1965.

CHANGES IN EXISTING LAW

In compliance with subsection 4 of rule XXIX of the Standing Rules of the Senate, changes in existing law made by the bill are shown as follows (existing law proposed to be omitted is enclosed in black brackets; new matter is printed in italic; existing law in which no change is proposed is shown in roman):

INTERNAL REVENUE CODE OF 1954

CHAPTER 1—NORMAL TAXES AND SURTAXES

* * * * *

Subchapter B—Computation of Taxable Income

* * * * *

PART II—ITEMS SPECIFICALLY INCLUDED IN GROSS INCOME

* * * * *

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

(a) GENERAL RULE FOR ANNUITIES.—Except as otherwise provided in this chapter, gross income includes any amount received as an annuity (whether for a period certain or during one or more lives) under an annuity, endowment, or life insurance contract.

(b) EXCLUSION RATIO.—Gross income does not include that part of any amount received as an annuity under an annuity, endowment, or life insurance contract which bears the same ratio to such amount as the investment in the contract (as of the annuity starting date) bears to the expected return under the contract (as of such date). This subsection shall not apply to any amount to which subsection (d)(1) (relating to certain employee annuities) applies.

8 TAX TREATMENT—CERTAIN MEMBERS OF UNIFORMED SERVICES

(c) DEFINITIONS.—

(1) **INVESTMENT IN THE CONTRACT.**—For purposes of subsection (b), the investment in the contract as of the annuity starting date is—

(A) the aggregate amount of premiums or other consideration paid for the contract, 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.

(2) **ADJUSTMENT IN INVESTMENT WHERE THERE IS REFUND FEATURE.**—If—

(A) the expected return under the contract depends in whole or in part on the life expectancy of one or more individuals;

(B) the contract provides for payments to be made to a beneficiary (or to the estate of an annuitant) or on after the death of the annuitant or annuitants; and

(C) such payments are in the nature of a refund of the consideration paid,

then the value (computed without discount for interest) of such payments on the annuity starting date shall be subtracted from the amount determined under paragraph (1). Such value shall be computed in accordance with actuarial tables prescribed by the Secretary or his delegate. For purposes of this paragraph and of subsection (e)(2)(A), the term "refund of the consideration paid" includes amounts payable after the death of an annuitant by reason of a provision in the contract for a life annuity with minimum period of payments certain, but (if part of the consideration was contributed by an employer) does not include that part of any payment to a beneficiary (or to the estate of the annuitant) which is not attributable to the consideration paid by the employee for the contract as determined under paragraph (1)(A).

(3) **EXPECTED RETURN.**—For purposes of subsection (b), the expected return under the contract shall be determined as follows:

(A) **LIFE EXPECTANCY.**—If the expected return under the contract, for the period on and after the annuity starting date, depends in whole or in part on the life expectancy of one or more individuals, the expected return shall be computed with reference to actuarial tables prescribed by the Secretary or his delegate.

(B) **INSTALLMENT PAYMENTS.**—If subparagraph (A) does not apply, the expected return is the aggregate of the amounts receivable under the contract as an annuity.

(4) **ANNUITY STARTING DATE.**—For purposes of this section, the annuity starting date in the case of any contract is the first day of the first period for which an amount is received as an annuity under the contract; except that if such date was before January 1, 1954, then the annuity starting date is January 1, 1954.

(d) EMPLOYEES' ANNUITIES.—

(1) EMPLOYEE'S CONTRIBUTIONS RECOVERABLE IN 3 YEARS.—

Where—

(A) part of the consideration for an annuity, endowment, or life insurance contract is contributed by the employer, and

(B) during the 3-year period beginning on the date (whether or not before January 1, 1954) on which an amount is first received under the contract as an annuity, the aggregate amount receivable by the employee under the terms of the contract is equal to or greater than the consideration for the contract contributed by the employee,

then all amounts received as an annuity under the contract shall be excluded from gross income until there has been so excluded (under this paragraph and prior income tax laws) an amount equal to the consideration for the contract contributed by the employee. Thereafter all amounts so received under the contract shall be included in gross income.

(2) SPECIAL RULES FOR APPLICATION OF PARAGRAPH (1).—For purposes of paragraph (1)—

(A) if the employee died before any amount was received as an annuity under the contract, the words "receivable by the employee" shall be read as "receivable by a beneficiary of the employee"; and

(B) any contribution made with respect to the contract while the employee is an employee within the meaning of section 401(c)(1) which is not allowed as a deduction under section 404 shall be treated as consideration for the contract contributed by the employee.

(3) CROSS REFERENCE.—

For certain rules for determining whether amounts contributed by employer are includible in the gross income of the employee, see part I of subchapter D (sec. 401 and following, relating to pension, profit-sharing, and stock bonus plans, etc.).

* * * * *

(o) ANNUITIES UNDER RETIRED SERVICEMAN'S FAMILY PROTECTION PLAN.—Subsections (b) and (d) shall not apply in the case of amounts received after December 31, 1965, as an annuity under chapter 73 of title 10 of the United States Code, but all such amounts shall be excluded from gross income until there has been so excluded (under section 122(b)(1) or this section, including amounts excluded before January 1, 1966) an amount equal to the consideration for the contract (as defined by section 122(b)(2)), plus any amount treated pursuant to section 101(b)(2)(D) as additional consideration paid by the employee. Thereafter all amounts so received shall be included in gross income.

* * * * *

PART III—ITEMS SPECIFICALLY EXCLUDED FROM GROSS INCOME

- Sec. 101. Certain death benefits.
- Sec. 102. Gifts and inheritances.
- Sec. 103. Interest on certain governmental obligations.
- Sec. 104. Compensation for injuries or sickness.
- Sec. 105. Amounts received under accident and health plans.

10 TAX TREATMENT—CERTAIN MEMBERS OF UNIFORMED SERVICES

- Sec. 106. Contributions by employer to accident and health plans.
- Sec. 107. Rental value of parsonages.
- Sec. 108. Income from discharge of indebtedness.
- Sec. 109. Improvements by lessee on lessor's property.
- Sec. 110. Income taxes paid by lessee corporation.
- Sec. 111. Recovery of bad debts, prior taxes, and delinquency amounts.
- Sec. 112. Certain combat pay of members of the Armed Forces.
- Sec. 113. Mustering-out payments for members of the Armed Forces.
- Sec. 114. Sports programs conducted for the American National Red Cross.
- Sec. 115. Income of States, municipalities, etc.
- Sec. 116. Partial exclusion of dividends received by individuals.
- Sec. 117. Scholarships and fellowship grants.
- Sec. 118. Contributions to the capital of a corporation.
- Sec. 119. Meals or lodging furnished for the convenience of the employer.
- Sec. 121. Gain from sale or exchange of residence of individual who has attained age 65.
- [Sec. 122. Cross references to other Acts.]
- Sec. 122. Certain reduced uniformed services retirement pay.
- Sec. 123. Cross references to other Acts.

SEC. 101. CERTAIN DEATH BENEFITS.

(b) EMPLOYEES' DEATH BENEFITS.—

(1) **GENERAL RULE.**—Gross income does not include amounts received (whether in a single sum or otherwise) by the beneficiaries or the estate of an employee, if such amounts are paid by or on behalf of an employer and are paid by reason of the death of the employee.

(2) **SPECIAL RULES FOR PARAGRAPH (1).**—

(A) **\$5,000 LIMITATION.**—The aggregate amounts excludable under paragraph (1) with respect to the death of any employee shall not exceed \$5,000.

(B) **NONFORFEITABLE RIGHTS.**—Paragraph (1) shall not apply to amounts with respect to which the employee possessed, immediately before his death, a nonforfeitable right to receive the amounts while living. This subparagraph shall not apply to total distributions payable (as defined in section 402(a)(3)) which are paid to a distributee within one taxable year of the distributee by reason of the employee's death—

(i) by a stock bonus, pension, or profit-sharing trust described in section 401(a) which is exempt from tax under section 501(a),

(ii) under an annuity contract under a plan described in section 403(a), or

(iii) under an annuity contract purchased by an employer which is an organization referred to in section 503(b) (1), (2), or (3) and which is exempt from tax under section 501(a), but only with respect to that portion of such total distributions payable which bears the same ratio to the amount of such total distributions payable which is (without regard to this subsection) includible in gross income, as the amounts contributed by the employer for such annuity contract which are excludable from gross income under section 403(b) bear

to the total amounts contributed by the employer for such annuity contract.

(C) **JOINT AND SURVIVOR ANNUITIES.**—Paragraph (1) shall not apply to amounts received by a surviving annuitant under a joint and survivor's annuity contract after the first day of the first period for which an amount was received as an annuity by the employee (or would have been received if the employee had lived).

(D) **OTHER ANNUITIES.**—In the case of any amount to which section 72 (relating to annuities, etc.) applies, the amount which is excludable under paragraph (1) (as modified by the preceding subparagraphs of this paragraph) shall be determined by reference to the value of such amount as of the day on which the employee died. Any amount so excludable under paragraph (1) shall, for purposes of section 72, be treated as additional consideration paid by the employee. *Paragraph (1) shall not apply in the case of an annuity under chapter 73 of title 10 of the United States Code if the individual who made the election under such chapter died after attaining retirement age.*

(3) **SELF-EMPLOYED INDIVIDUAL NOT CONSIDERED AN EMPLOYEE.**—For purposes of this subsection, the term "employee" does not include an individual who is an employee within the meaning of section 401(c)(1) (relating to self-employed individuals).

* * * * *

SEC. 122. CERTAIN REDUCED UNIFORMED SERVICES RETIREMENT PAY.

(a) **GENERAL RULE.**—*In the case of a member or former member of the uniformed services of the United States who has made an election under chapter 73 of title 10 of the United States Code to receive a reduced amount of retired or retainer pay, gross income does not include the amount of any reduction after December 31, 1965, in his retired or retainer pay by reason of such election.*

(b) **SPECIAL RULE.**—

(1) **AMOUNT EXCLUDED FROM GROSS INCOME.**—*In the case of any individual referred to in subsection (a), all amounts received after December 31, 1965, as retired or retainer pay shall be excluded from gross income until there has been so excluded an amount equal to the consideration for the contract. The preceding sentence shall apply only to the extent that the amounts received would, but for such sentence, be includible in gross income.*

(2) **CONSIDERATION FOR THE CONTRACT.**—*For purposes of paragraph (1) and section 72(o), the terms "consideration for the contract" means, in respect of any individual, the sum of—*

(A) *the total amount of the reductions before January 1, 1966, in his retired or retainer pay by reason of an election under chapter 73 of title 10 of the United States Code, and*

(B) *any amounts deposited at any time by him pursuant to section 1438 of such title 10.*

* * * * *

SEC. [122] 123. CROSS REFERENCES TO OTHER ACTS.

* * * * *

CHAPTER 11—ESTATE TAX

Subchapter A—Estates of Citizens or Residents

PART III—GROSS ESTATE

SEC. 2039. ANNUITIES.

(a) **GENERAL.**—The gross estate shall include the value of an annuity or other payment receivable by any beneficiary by reason of surviving the decedent under any form of contract or agreement entered into after March 3, 1931 (other than as insurance under policies on the life of the decedent), if, under such contract or agreement, an annuity or other payment was payable to the decedent, or the decedent possessed the right to receive such annuity or payment, either alone or in conjunction with another for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death.

(b) **AMOUNT INCLUDIBLE.**—Subsection (a) shall apply to only such part of the value of the annuity or other payment receivable under such contract or agreement as is proportionate to that part of the purchase price therefor contributed by the decedent. For purposes of this section, any contribution by the decedent's employer or former employer to the purchase price of such contract or agreement (whether or not to an employee's trust or fund forming part of a pension, annuity, retirement, bonus or profit-sharing plan) shall be considered to be contributed by the decedent if made by reason of his employment.

(c) **EXEMPTION OF ANNUITIES UNDER CERTAIN TRUSTS AND PLANS.**—Notwithstanding the provisions of this section or of any provision of law, there shall be excluded from the gross estate the value of an annuity or other payment receivable by any beneficiary (other than the executor) under—

(1) an employees' trust (or under a contract purchased by an employees' trust) forming part of a pension, stock bonus, or profit-sharing plan which, at the time of the decedent's separation from employment (whether by death or otherwise), or at the time of termination of the plan if earlier, met the requirements of section 401(a);

(2) a retirement annuity contract purchased by an employer and not by an employees' trust) pursuant to a plan which, at the time of decedent's separation from employment (by death, or otherwise), or at the time of termination of the plan if earlier, was a plan described in section 403(a); **[or]**

(3) a retirement annuity contract purchased for an employee by an employer which is an organization referred to in section 503 (b) (1), (2), or (3), and which is exempt from tax under section 501(a) **[.]; or**

(4) *chapter 73 of title 10 of the United States Code.*

If such amounts payable after the death of the decedent under a plan described in paragraph (1) or **[(2) or]** (2), under a contract described in paragraph (3), or *under chapter 73 of title 10 of the United States Code* are attributable to any extent to payments or contributions made by the decedent, no exclusion shall be allowed for that part of the

value of such amounts in the proportion that the total payments or contributions made by the decedent bears to the total payments or contributions made. For purposes of this subsection, contributions or payments made by the decedent's employer or former employer under a trust or plan described in paragraph (1) or (2) shall not be considered to be contributed by the decedent, and contributions or payments made by the decedent's employer or former employer toward the purchase of an annuity contract described in paragraph (3) shall, to the extent excludable from gross income under section 403(b), not be considered to be contributed by the decedent. For purposes of this subsection, contributions or payments on behalf of the decedent while he was an employee within the meaning of section 401(c)(1) made under a trust or plan described in paragraph (1) or (2) shall be considered to be contributions or payments made by the decedent. *For purposes of this subsection, amounts payable under chapter 73 of title 10 of the United States Code are attributable to payments or contributions made by the decedent only to the extent of amounts deposited by him pursuant to section 1438 of such title 10.*

CHAPTER 12—GIFT TAX

* * * * *

Subchapter B—Transfers

* * * * *

SEC. 2517. CERTAIN ANNUITIES UNDER QUALIFIED PLANS.

(a) **GENERAL RULE.**—The exercise or nonexercise by an employee of an election or option whereby an annuity or other payment will become payable to any beneficiary at or after the employee's death shall not be considered a transfer for purposes of this chapter if the option or election and annuity or other payment is provided for under—

(1) an employees' trust (or under a contract purchased by an employees' trust) forming part of a pension, stock bonus, or profit-sharing plan which, at the time of such exercise or nonexercise, or at the time of termination of the plan if earlier, met the requirements of section 401(a);

(2) a retirement annuity contract purchased by an employer (and not by an employees' trust) pursuant to a plan which, at the time of such exercise or nonexercise, or at the time of termination of the plan if earlier, was a plan described in section 403(a);

[or]

(3) a retirement annuity contract purchased for an employee by an employer which is an organization referred to in section 503(b) (1), (2), or (3), and which is exempt from tax under section 501(a) **[.]**; or

(4) *chapter 73 of title 10 of the United States Code.*

(b) **TRANSFERS ATTRIBUTABLE TO EMPLOYEE CONTRIBUTIONS.**—If the annuity or other payment referred to in subsection (a) (*other than paragraph (4)*) is attributable to any extent to payments or contributions made by the employee, then subsection (a) shall not apply to that part of the value of such annuity or other payment which bears the same proportion to the total value of the annuity or other payment as the total payments or contributions made by the employee

14 TAX TREATMENT—CERTAIN MEMBERS OF UNIFORMED SERVICES

bear to the total payments or contributions made. For purposes of the preceding sentence, payments or contributions made by the employee's employer or former employer toward the purchase of an annuity contract described in subsection (a)(3) shall, to the extent not excludable from gross income under section 403(b), be considered to have been made by the employee. For purposes of this subsection, payments or contributions on behalf of an individual while he was an employee within the meaning of section 401(c)(1) made under a trust or plan described in subsection (a)(1) or (2) shall be considered to be payments or contributions made by the employee.

(c) **EMPLOYEE DEFINED.**—For purposes of this section, the term "employee" includes a former employee.

