Revenue Ruling 69-74

Private Annuity In Exchange for Appreciated Property

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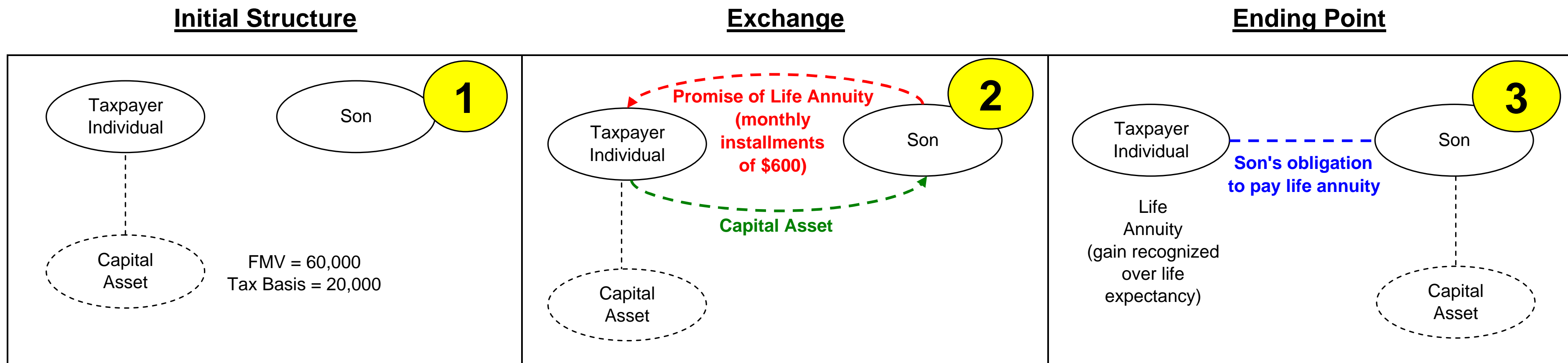

The taxpayer, age 74, transferred property (a capital asset) having an adjusted basis of $20,000, and a fair market value of $60,000, to his son in 1966, in exchange for the legally enforceable promise of the latter to pay him a life annuity of $7,200 per annum payable in equal monthly installments of $600. Section 72(b) provides that gross income does not include that part of any amount received as an annuity which bears the same ratio to such amount as the investment in the contract bears to the expected return under the contract. The tax consequences are as follows:

1. The present value of the annuity is determined to be $47,713 (Reg. 20.2031-7 tables).
2. The gain realized on the transaction is $27,713 (present value of the annuity [$47,713] less transferor's basis [$20,000]).
3. The gift from father to son is $12,287 (FMV of the property transferred [$60,000] less present value of the annuity [$47,713]).
4. The gain is reported ratably over the period of years measured by the annuitant's life expectancy under section 72, as follows:

   Expected return = $72,720 (annual proceeds multiplied by 10.1, the life expectancy).
   Investment in the contract = $20,000 (transferor's basis)
   Exclusion ratio = 27.5%. (investment in the contract [$20,000] / expected return [$72,720])
   Annual proceeds = $7,200
   Annual exclusion = $1,980 (27.5% of $7,200)
   Annual capital gain = $2,744 ($27,713 divided by 10.1 years life expectancy)
   Annual ordinary income = $2,476 (proceeds less exclusion and less capital gain)

After the capital gain of $27,713 has been fully reported, subsequent amounts received (after applying the exclusion ratio) are to be reported as ordinary income. **Note that on October 17, 2006, the Treasury Department and IRS released proposed regulations under sections 72 and 1001 (REG-141901-05) which would supercede this ruling.**

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