# FAIRNESS DOES NOT OVERRIDE INTERNAL REVENUE CODE RULES ON TAXATION OF ANNUITY PAYMENTS

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Employee Benefits

When an individual has made after-tax contributions to a defined benefit plan, the individual is entitled to receive those amounts tax-free when distributions are made. Internal Revenue Code Section 72(d) provides for a simplified method of recovering the "investment in the contract," the portion of the payments representing the non-taxable return of the individual's contributions. Under this simplified rule the investment in the contract is divided by a number of payments based on the age of the individual at the annuity starting date. In a recent tax court case an individual retired at age 55. Based on the simplified method, the number of payments utilized to recover the investment in the contract is 360. In this case, the individual argued that the simplified method of recovering the investment in the contract was unfair because the individual had a preexisting medical condition which would shorten the individual's life expectancy. Under the simplified method, the individual would be age 85 by the time that he recovered the total investment in the contract. While the Tax Court was somewhat sympathetic to the individual's situation, it found that there was no means by which it could overturn the requirements of Internal Revenue Code Section 72(d) requiring recovery over 360 months. The Tax Court did note that should the individual die before all the investment in the contract was recovered, the unrecovered investment in the contract is allowed as a deduction on the individual's final income tax return. *Oliver v. Commissioner* (T.C. Summary Opinion 2018).