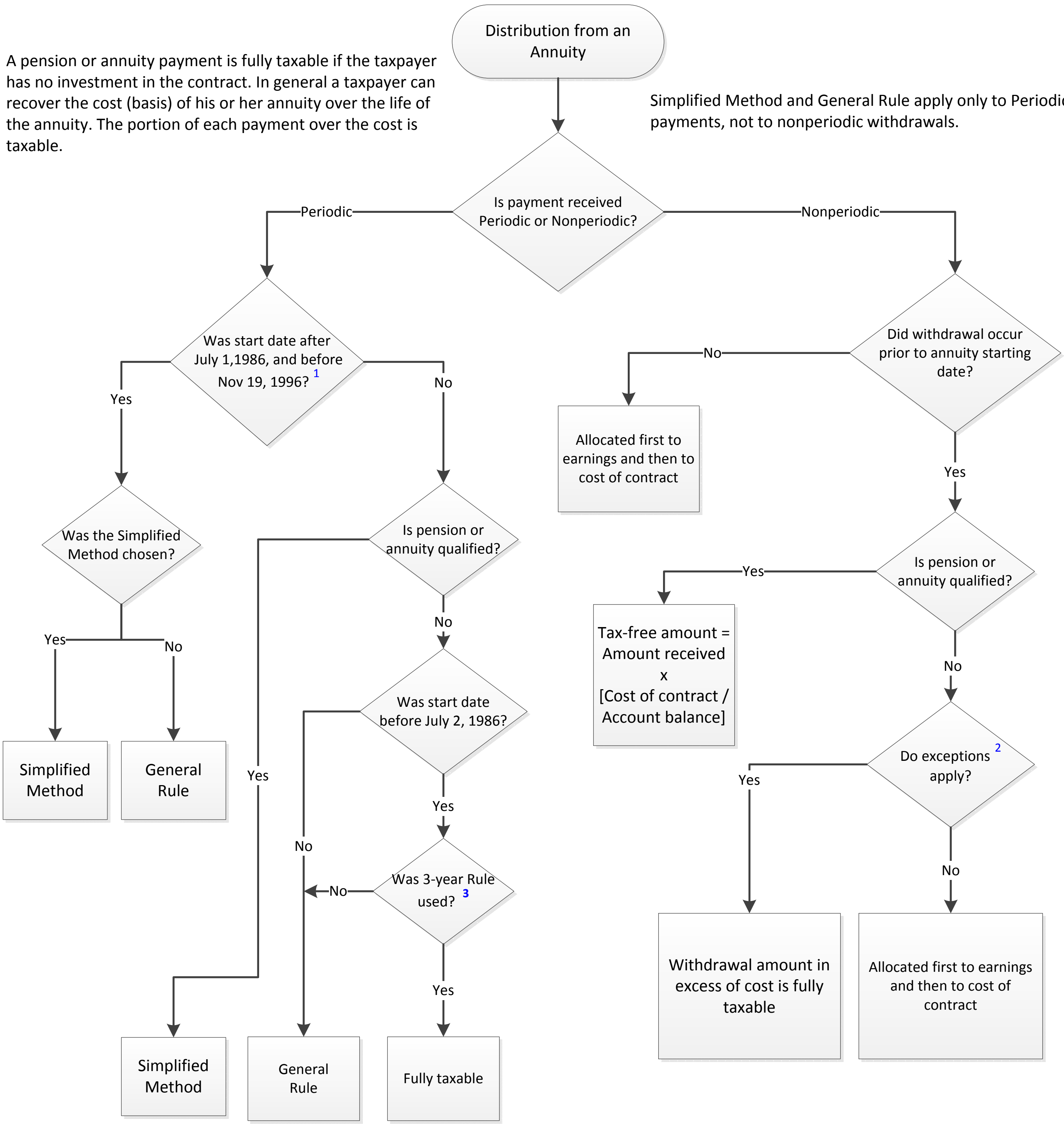
Determining the Taxability of Annuity Distributions

A pension or annuity payment is fully taxable if the taxpayer has no investment in the contract. In general a taxpayer can recover the cost (basis) of his or her annuity over the life of the annuity. The portion of each payment over the cost is taxable.

Simplified Method and General Rule apply only to Periodic payments, not to nonperiodic withdrawals.



[1] If annuity start date was between these dates, the taxpayer could have chosen to use either the Simplified Method or the General Rule.

[2] See Pub.575, p. 18, “Exception to allocation rule”

[3] The Three-Year Rule was repealed in 1986 for any taxpayer whose annuity starting date was after 7/1/86. A taxpayer was required to use this rule under an employer-sponsored pension or annuity if the employer paid part of the cost, and during the 3 years from the date of the first annuity payment, the total amount to be received would equal or exceed the taxpayer’s investment in the contract.