Legacy Planning: Dying With an Annuity

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AGENDA

- Dying with an annuity **with no** cash value
- Dying with an annuity **with** cash value
- Planning considerations
- Non-qualified stretch annuities
- Stretch Individual Retirement Account (IRA) rules
- Talk to your clients, and their beneficiaries

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ANNUITY STATISTICS

$2.53 trillion = **Total retirement annuity assets**

Statista, 2021 Survey
https://www.statista.com/statistics/188002/retirement-annuities-total-assets-in-the-us-since-2000/

$219 billion = **2020 total annuity sales**

LIMRA Secure Retirement Institute, 2020

51 years = **Average purchase age of non-qualified annuities**

Annuity Purchasers Are Getting Younger, Rachel Summit, 2020
https://www.annuityfyi.com/blog/2014/07/annuity-purchasers-are-getting-younger/

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ANNUITY STATISTICS

According to a Gallop survey of non-qualified annuity owners:

83%

intend to use their annuity to **avoid being a financial burden on their children**.

73%

intend to use their annuity as an **emergency fund for catastrophic illness or nursing home care**.

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DYING WITH AN ANNUITY

is sometimes considered the worst asset to leave behind.

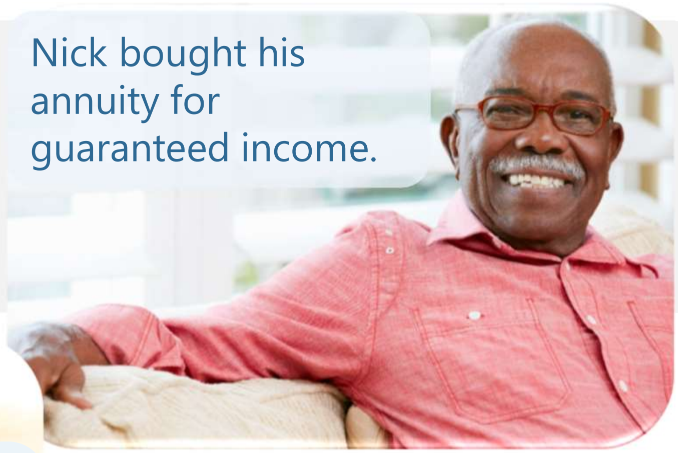
Why is that?

From a tax perspective:

- No step-up in cost basis at death
- Restrictions on when and how funds can be distributed
- And lastly, someone has to pay taxes!

DO YOUR CLIENTS' HAVE PLANS FOR THEIR ANNUITIES?

Plans are in place for clients' overall portfolios. Do they have a plan in place for their annuity?



Nick bought his annuity for guaranteed income.

Stacey bought her annuity to provide principal protection and growth.

Each of these client scenarios provide different options and require different plans in order to create tax efficiency.

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WHAT HAPPENS TO AN ANNUITY UPON THE CLIENT'S DEATH?

The short answer is that it depends on the type of annuity owned. It also depends on the payout options' structure and the death benefit terms.

- **Two annuity phases:**
  - Growth phase (payments in and/or deferral period)
  - Distribution phase (income paid out)

- **Annuitization** - Is the annuity your client purchased an annuitized annuity?
  - Single premium immediate annuity (SPIA)
  - Deferred income annuity (DIA)
  - Annuitized income benefits

DYING WITH AN ANNUITY WITH CASH VALUE

Meet Stacey:

- She's a conservative investor.
- She purchased her annuity for principal protection and to help manage portfolio volatility.
- Her three children are the beneficiaries.
- She purchased her annuity contract for $500,000 with after-tax non-qualified funds, and it's now worth $900,000. That is $400,000 of taxable gain.

Stacey bought her annuity to provide principal protection and growth.

WHAT ARE THE FINANCIAL PLANNING CONSIDERATIONS POST DEATH?

Financial and client factors to consider:

- Tax Implications
- Beneficiary Goals
- Liquidity

Each beneficiary situation is unique.

CONSIDERATIONS - TAXES

- Annuity values grow tax deferred during the deferral phase
- Distributions from non-qualified is last in, first out (LIFO)
- Distributions from IRA/pre tax is 100% taxable at ordinary income
- Pay taxes now, versus paying taxes later
- Is there a more efficient way to distribute funds over time?

CONSIDERATIONS – BENEFICIARY GOALS

Key questions to ask:

- Did the original annuity purchaser buy the annuity as a leave-on asset?
- What is the relationship between the owner and beneficiary? Common beneficiary elections are:
  - Family
  - Charities
  - Friends
- What are the beneficiaries' goals with the money they are receiving?
  - Income?
  - Growth?
  - Pay off debt?

CONSIDERATIONS - LIQUIDITY

- Each beneficiary's goal may be different from other beneficiaries'.
- Does the beneficiary need the lump sum today, or over time?
- Beneficiaries make individual elections:
  - One beneficiary can take the lump sum amount
  - Another beneficiary can "stretch" the distributions over time

NON-QUALIFIED STRETCH (NQS)

- Available on non-qualified funds only
- Beneficiaries can spread taxation of the gain portion over their lifetime, determined at the time of election.
- A portion of each scheduled payment is not taxed.
- Allows the annuity to continue to grow **tax-deferred** over the beneficiary's lifetime.
- Scheduled distributions, when limited to the beneficiary's life expectancy, are taxed as annuity distributions using an exclusion ratio. Each scheduled distribution is part return of cost basis (or premium paid into the annuity) and part gain. Only the **gain** portion of each scheduled distribution is subject to income taxation.

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NON-QUALIFIED STRETCH (NQS) CONT.

- Payments can be calculated by:
  - Using the single life IRS life expectancy table
  - Prior year's December 31st annuity value is divided by the life expectancy number
  - This calculation determines the required distribution amount
  - Some carriers structure NQS without exclusion ratio, and use LIFO distributions
- Payments must start within 12 months of the original owner's date of death
- Additional details leverage Crump wholesalers' expertise:
  - There is a specific ownership structure and titling of the new contract ownership: "John Smith, beneficiary of deceased Barbara Smith"
  - Ceding carrier may ask for a letter of acceptance to verify the new contract is setup as a NQS contract
  - Not all carriers in the industry will 1035 exchange a death benefit
  - Next to impossible to implement a NQS upon a trust that is the beneficiary

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THE SECURE ACT: STRETCH IRA CHANGES

- The Secure Act, passed in 2019, effectively eliminated the traditional "Stretch IRA"
  - Dates of death prior to 12/31/2019 are grandfathered
  - Dates of death post 1/1/20 subject to new rules
  - Spousal continuance remains unchanged
  - New rules apply to non-spousal beneficiaries
  - All funds have to be distributed from the account no later than 10 years after the date of death
- Non-spousal beneficiaries now have three options:
  1) Withdrawal assets as evenly as possible over the 10 years
  2) Wait until the end of the 10 year period and withdrawal all assets
  3) Make irregular withdrawals over the 10 year period

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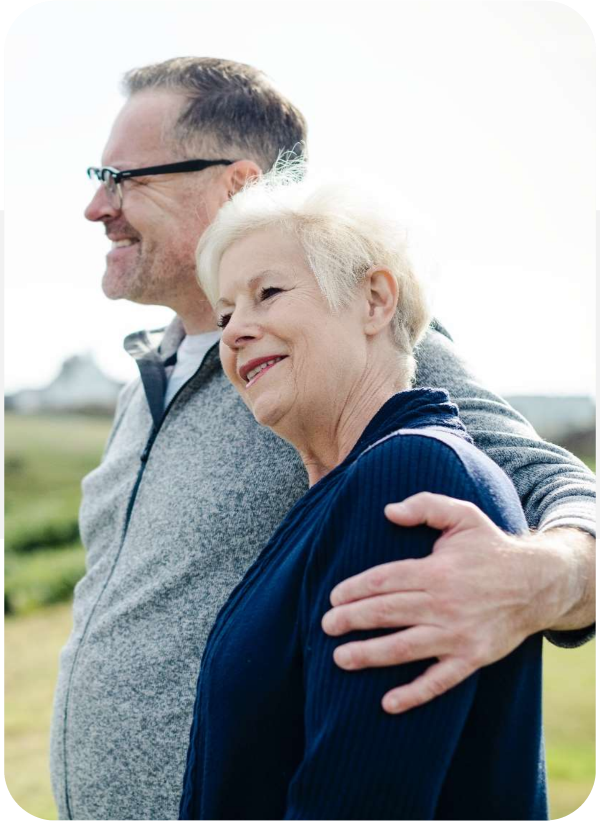
TALK TO YOUR CLIENTS AND THEIR BENEFICIARIES

- **Use the beneficiary elections as a door opener:**

"Mr. Client, I see that you named your son as a beneficiary and there is going to be taxable gain inside of the annuity at death. Can you introduce us, so we can put a plan in place?"



- Leverage Crump's **Annuity Policy Review** (APR) process to start the conversation with existing clients.

QUESTIONS?