

Estate Planning with Annuities, IRAs and Qualified Plan Assets



Annuities and retirement plan assets can be powerful tools to help you save for retirement because they grow on a tax-deferred basis and are generally not subject to income tax until they are distributed. If your income tax bracket decreases after you retire, the advantages of using annuities and retirement plans can increase.

Because of the severe taxes applied to qualified retirement assets and the complex rules governing their distribution, it's important to coordinate them with your estate plan.

Like your other assets, annuities and retirement assets remaining at your death may be subject to estate tax. However, because distributions will also be subject to income tax, the combination of the income tax on distributions and the estate tax can consume more than 70% of your retirement assets.

COORDINATE RETIREMENT ASSETS WITH YOUR ESTATE PLAN

Your goals, asset structure, age, income needs, and other factors will influence how you will handle distributions from, and beneficiary designations for, your qualified plans. Discuss these options with your advisors:

Defer Distributions as Long as Possible

Because retirement assets grow income tax deferred, you may choose to structure your estate plan to spread asset distributions over the longest possible period. But deferral opportunities are limited — you must ordinarily accept required minimum distributions from qualified plans or IRAs once you reach age 70½. The balance of the assets that remain at your death may be subject to estate tax, as well as income tax.

Deferred annuities generally do not require that the annuitant take distributions during life; therefore potentially allowing you to defer taking distributions for as long as you choose.

Start Distributions Prior to Age 70½

You may choose to start taking distributions between ages 59½ and 70½ to satisfy your retirement income needs, thereby reducing your retirement asset balances. If you take distributions from an annuity or retirement plan prior to age 59½, you will ordinarily have to pay a 10% penalty for early withdrawal.

Purchase Life Insurance in an Irrevocable Trust

You may use a portion of your distributions to purchase single life or survivorship life insurance to:

- Pay the estate and income taxes on your qualified plan assets.
- Create a death benefit that can pass to your beneficiaries free of the income tax and estate tax.
- Replace the value of assets going to charity.
- Reduce the size of your taxable estate.

Annuity Maximization example:

Wayne (age 64) and Fran Kershner (age 61) have a combined \$25,450,000 estate, including a \$1,450,000 deferred annuity. If they allow the annuity to grow in their estate at an annual rate of 5%, without taking any withdrawals from it, after 27 years the net to heirs from a \$5,413,512 annuity will be \$2,287,209 (after estate and income taxes*). If they "annuitize" the annuity over their joint lives, they can use the after tax distributions to make gifts to an irrevocable trust. The trust can use the gifts to buy a life insurance policy with an initial face amount of \$5,163,087. If the trust is set up properly, the life insurance proceeds should be free of estate and income tax.

Comparison of Net to Heirs at Life Expectancy at Year 27

Keep Annuity vs. Annuitize & Purchase Life Insurance

Scenario 1:

Keep Annuity

Estate Tax \$1,231,574 **

Income Tax \$1,894,729

Net to Heirs \$2,287,209

Scenario 2:

Annuitize & Fund Irrevocable Life Insurance Trust

Net to Heirs \$ 5,163,087

** The 57.75% hypothetical combined tax rate is for illustration purposes only. Actual rates may vary.*

***Assumes a \$5,000,000 estate tax exemption per spouse with a top estate tax rate of 35% & IRD tax deduction from estate taxes for income taxes due.*

The 5% growth rate is hypothetical for illustration purposes only and does not represent the return of any particular investment.