



# Using Annuities for Individual Retirement Accounts (IRA's)

# IRA's and the Annuity Market

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- If you were to go outside, hand the next person you see a check, and ask him or her to use it to purchase a certificate of deposit, the typical person would know:
  - Where to buy a CD
  - That CD's are available in different durations
  - That they have an interest rate set by the bank that is guaranteed for the duration chosen
  
- If you were to go outside, hand that same person a check, and ask him or her to use it to purchase an annuity, the typical person would likely not know what an annuity is, how they work, or where one could be purchased

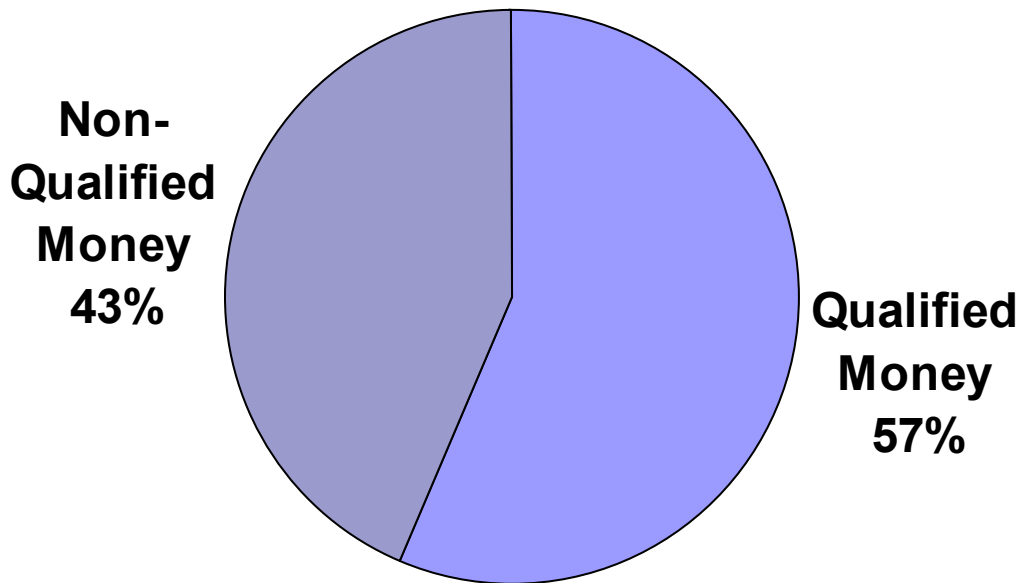
# IRA's and the Annuity Market, *continued*

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- And yet, there is approximately twice as much money in annuities as there is in bank certificates of deposit
  
- Why is that?
  - Annuities offer certain advantages over CD's
  - Any agent with a life insurance license can sell an annuity and earn a commission for doing so – many of your colleagues are deriving substantial additional income by offering annuities to their customers

# IRA's and the Annuity Market, *continued*

- More than half of annuity sales consist of qualified money, and the vast majority of those annuities are classified as IRA's under the tax code
- So, to sell annuities, you need to know something about IRA's



Source: LIMRA, 2006

# IRA's and the Annuity Market, *continued*

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## What is the sales opportunity for you, the agent?

- Everyone needs to save money for retirement, and establishing an IRA is one of the best ways to do so because the tax code gives preferential treatment to IRA's
  - Depending upon the type of IRA used, contributions could be tax-deductible and earnings could be tax-deferred or even tax-free
- People who have left money in a former employer's defined contribution retirement plan, such as a 401(k) plan, can roll that balance tax-free to an IRA
- By helping your clients to establish IRA's and/or roll over retirement plan balances, you are helping to secure their long-term financial security
- They can add money year after year to the IRA you help them establish

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# The Three Sources of Retirement Income

# Retirement Income Sources, *continued*

What are the three sources of income in retirement?



# Retirement Income Sources, *continued*

## What can retirees count on from Social Security?



Social  
Security

- Its primary purpose is to prevent the elderly from living in poverty
  - It was never meant to be the sole source of income in retirement
  - The average monthly benefit is only \$1,044 for a retired worker
- It is largely a “pay-as-you-go” system with today’s wage earners paying for the benefits of today’s retirees
  - Thus, the ratio of workers to beneficiaries is very important in setting payroll tax rates and benefit levels
  - This ratio was 16.5-to-1 in 1950, has fallen to 3.3-to-1 today, and is projected to fall to 2.1-to-1 in 25 years
- As a result, you can expect ...
  - Adjustments to the program over time such as rising payroll tax rates, reduced benefits, and increased retirement ages

Source: Social Security  
Administration

# Retirement Income Sources, *continued*

## What can retirees count on from company retirement plans?



### Company Retirement Plans

- Defined benefit plans are becoming scarce
  - 114,396 – Number of private company pension plans in 1985
  - 30,336 – Number currently
  - Zero – Estimated number of plans created in the past decade
  - \$340 billion – The amount of underfunding in corporate pension plans
  
- The Pension Benefit Guaranty Corporation ...
  - Is a government agency that takes over pension plans that have terminated
  - Currently has a deficit of \$18.9 billion
  
- As a result, you can expect ...
  - Even if you have a defined benefit pension plan, it is becoming less and less likely to still be in place when you retire

Source: The Dallas Morning News, Pension Benefit Guaranty Corporation

# Retirement Income Sources, *continued*

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**As a result ...**



**Personal  
Savings**

- Saving on your own for retirement is more important than ever!
- Congress has created tax incentives to promote retirement savings, such as
  - Traditional IRA's, which have tax-deductible contributions
  - Roth IRA's, which can create tax-free income

# Retirement Income Sources, *continued*

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## Why establish an IRA today?

If your client:

- Puts \$3,000 annually into an IRA until age 65, and
- Earns 8% interest per year ...

Then his or her balance at age 65 will be the following:

- \$839,343 if he or she starts funding the IRA at age 25
- \$367,037 if he or she starts funding the IRA at age 35
- \$148,268 if he or she starts funding the IRA at age 45
- \$46,936 if he or she starts funding the IRA at age 55

The time to start an IRA is today!



Can an Annuity be an IRA?

# Can an Annuity be an IRA?

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## Can I put IRA funds into an annuity?

- Yes!
- An IRA is not a particular type of account, rather it is just a designation that we place on a financial asset and that determines its tax treatment
- An IRA can be:
  - A certificate of deposit at a bank
  - Holdings of stock at a brokerage house
  - An account at a mutual fund company
  - An annuity at an insurance company
  - Or a variety of other things

# Can an Annuity be an IRA?, *continued*

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## Why would I choose an annuity for IRA funds?

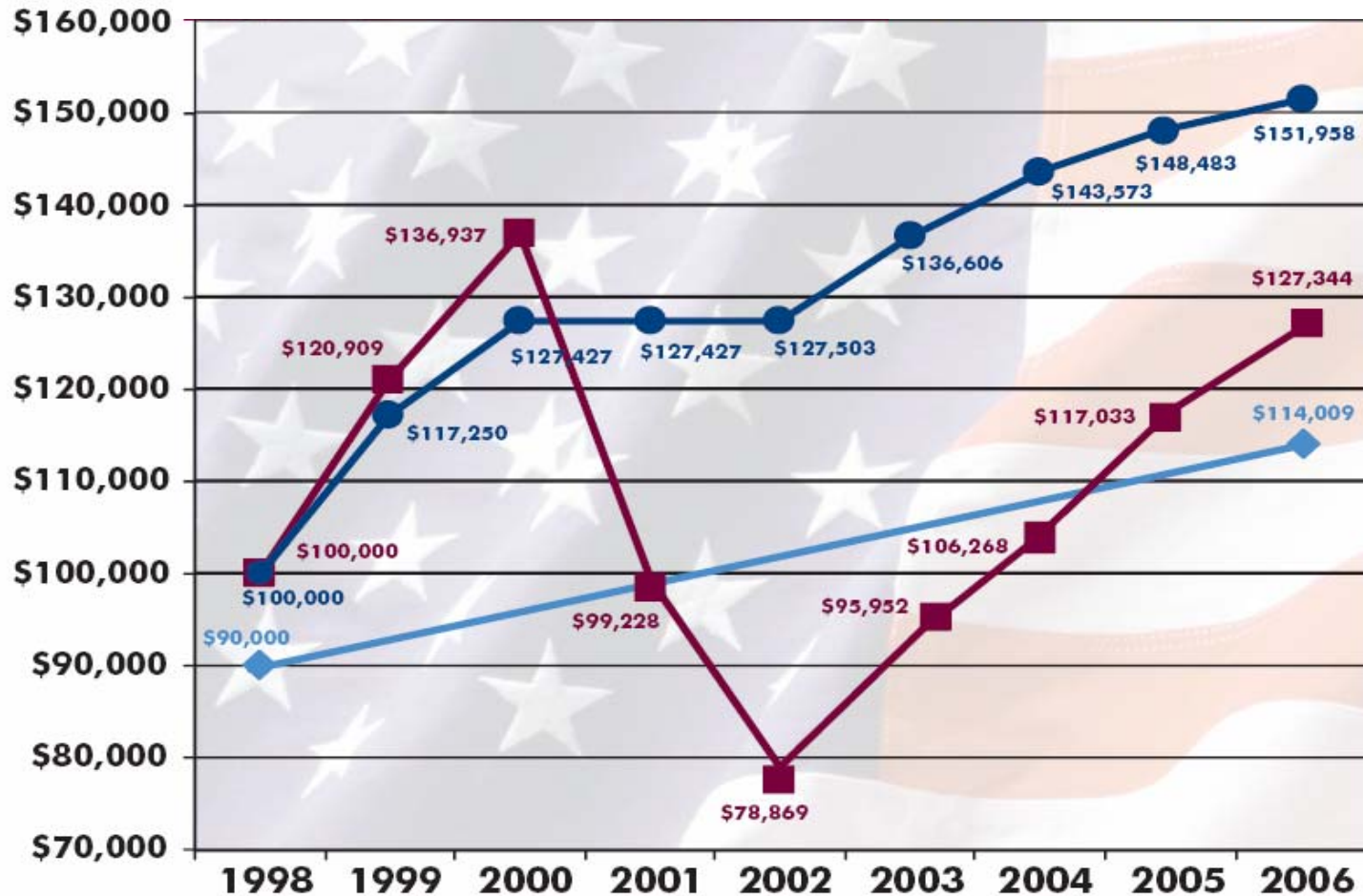
- Annuities are known for offering the advantage of tax deferral, but the IRA designation conveys tax deferral regardless of the underlying asset
  - So purchasing an annuity within an IRA that already provides tax deferral results in no additional tax benefit
  - **So you should purchase an annuity for its other features and benefits**
- ... such as: index annuities offer a unique blend of safety and growth potential**



# How Do I Present an Index Annuity to a Customer?

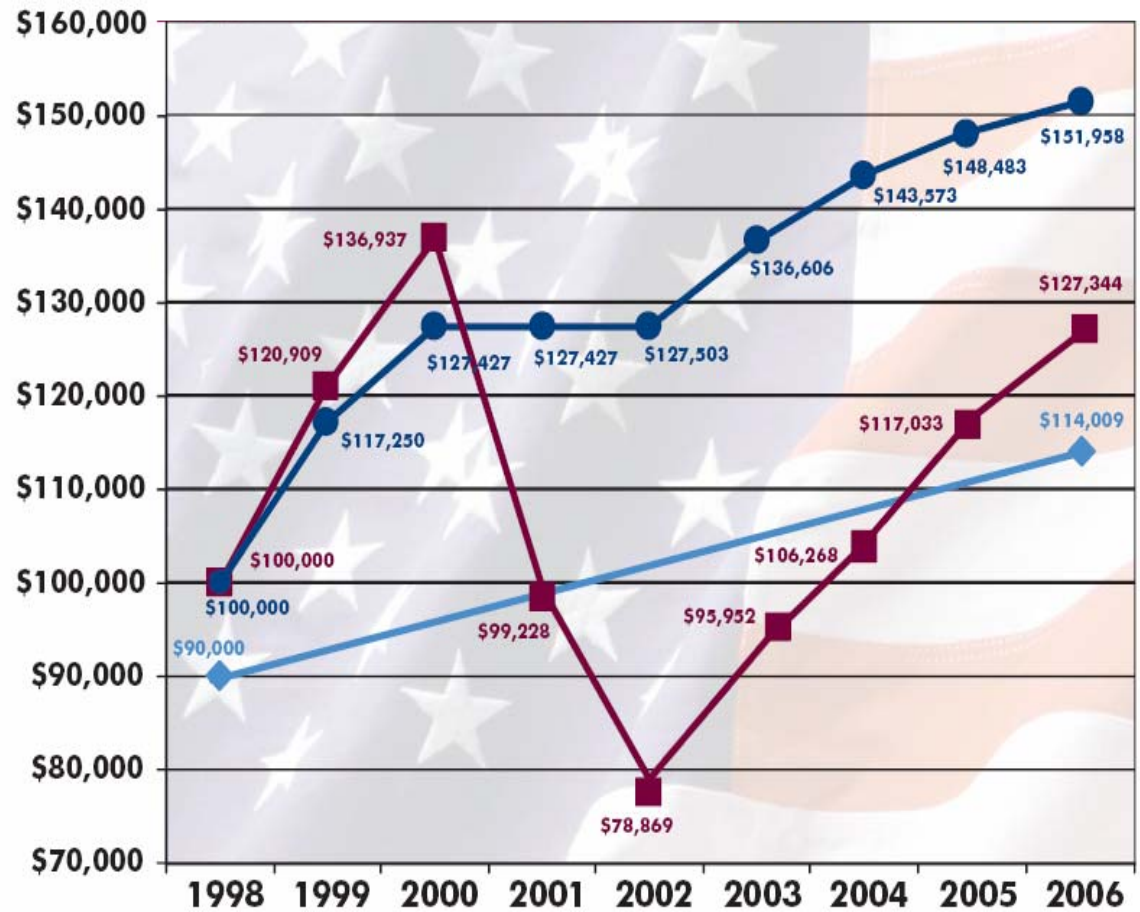
# Presenting an Index Annuity

Which line would you like your retirement savings to follow?



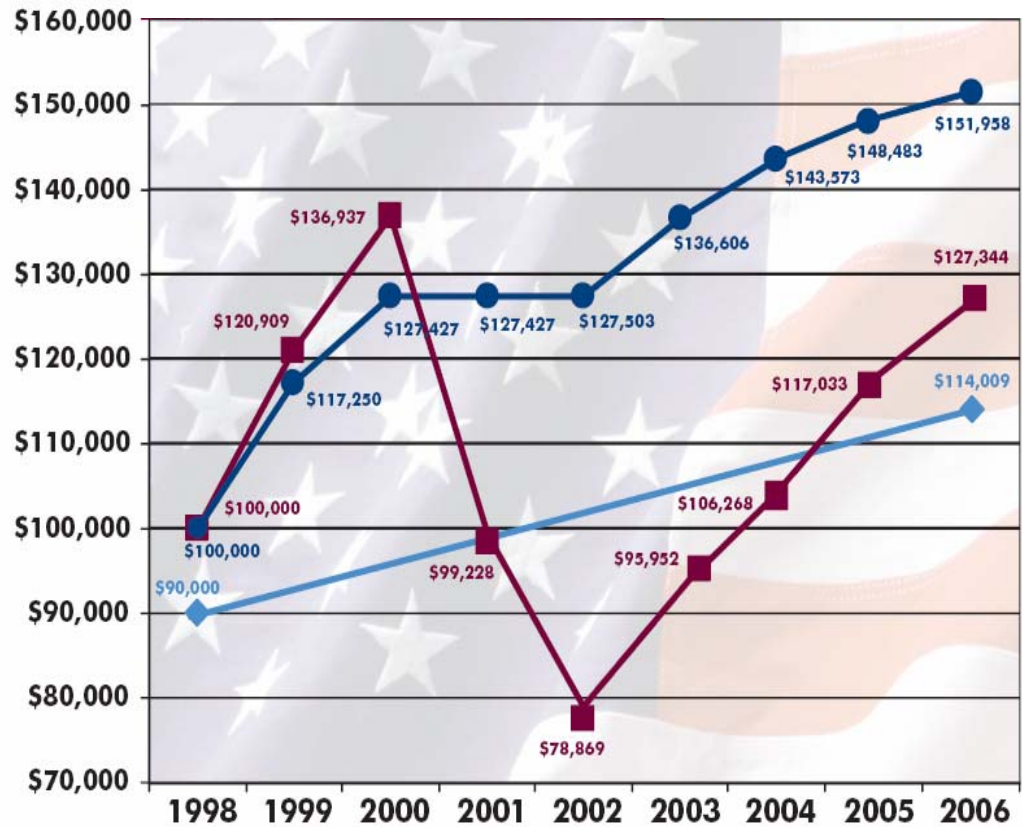
# Presenting an Index Annuity, *continued*

- The red line is the stock market, stock market mutual funds, and 401(k) plans
- **Risky!**



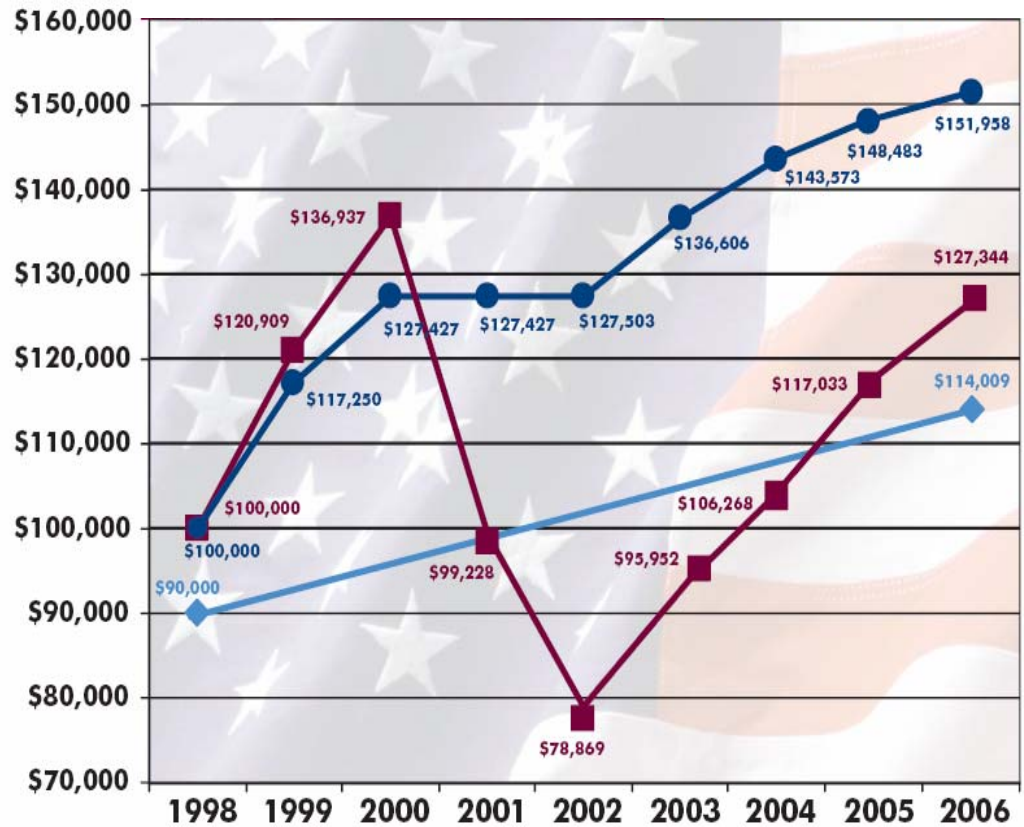
# Presenting an Index Annuity, *continued*

- The light blue line is savings accounts, bank CD's, and money market funds
- **Not much growth!**



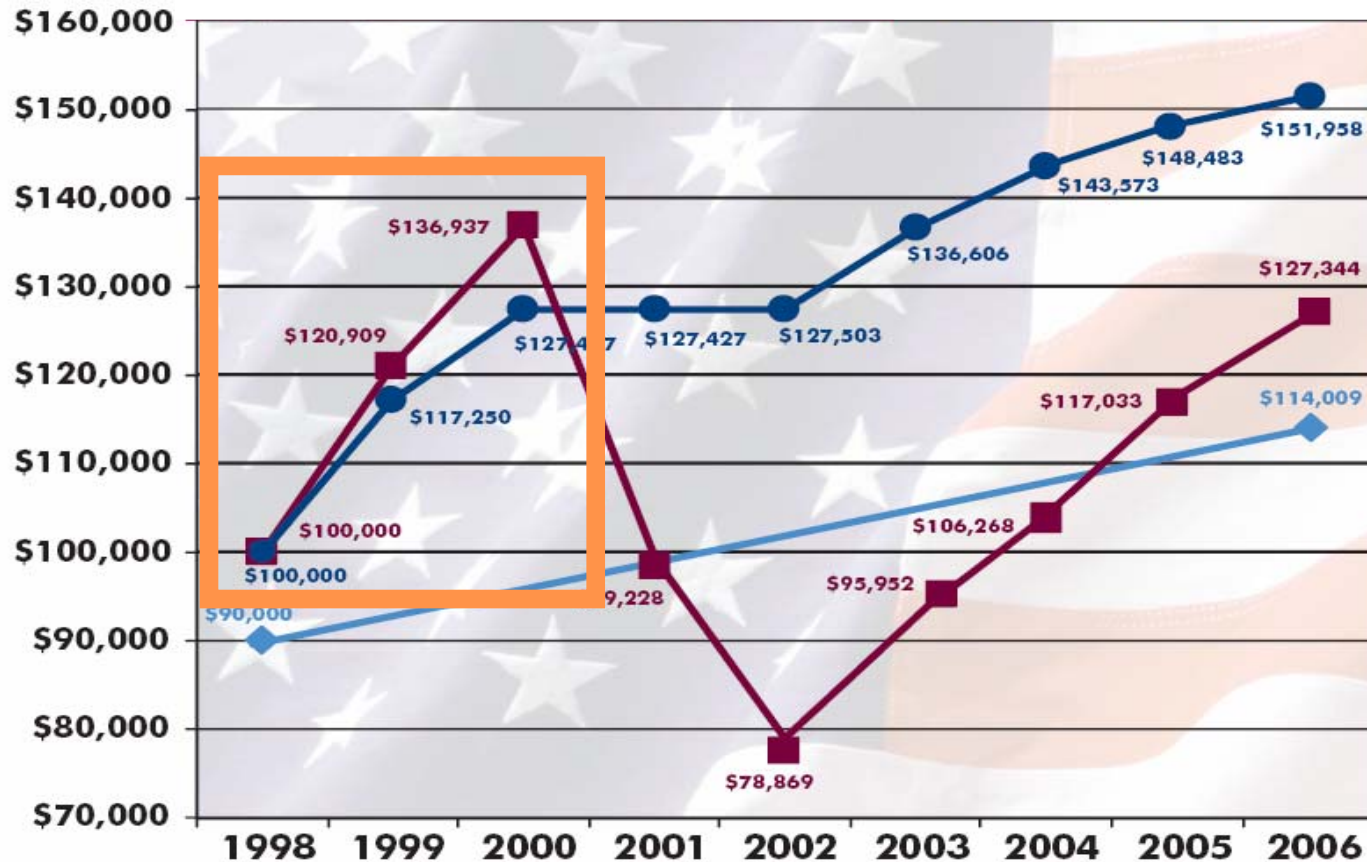
# Presenting an Index Annuity, *continued*

- The dark blue line is an index annuity
- **Growth and safety!**



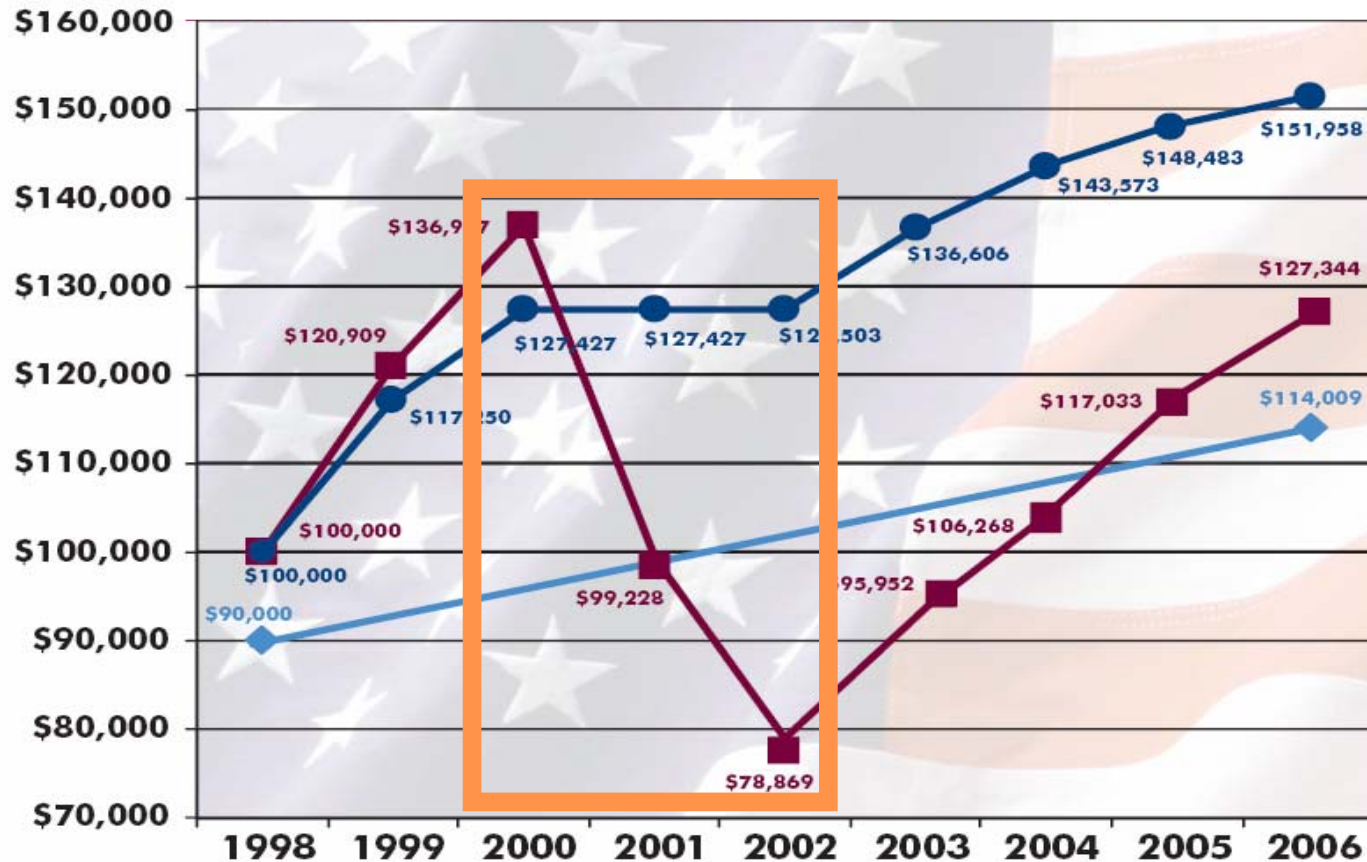
# Presenting an Index Annuity, *continued*

In a year that the stock market index increases, the annuity credits a portion of the index increase as interest. The bigger the index increase, the bigger the interest credit.



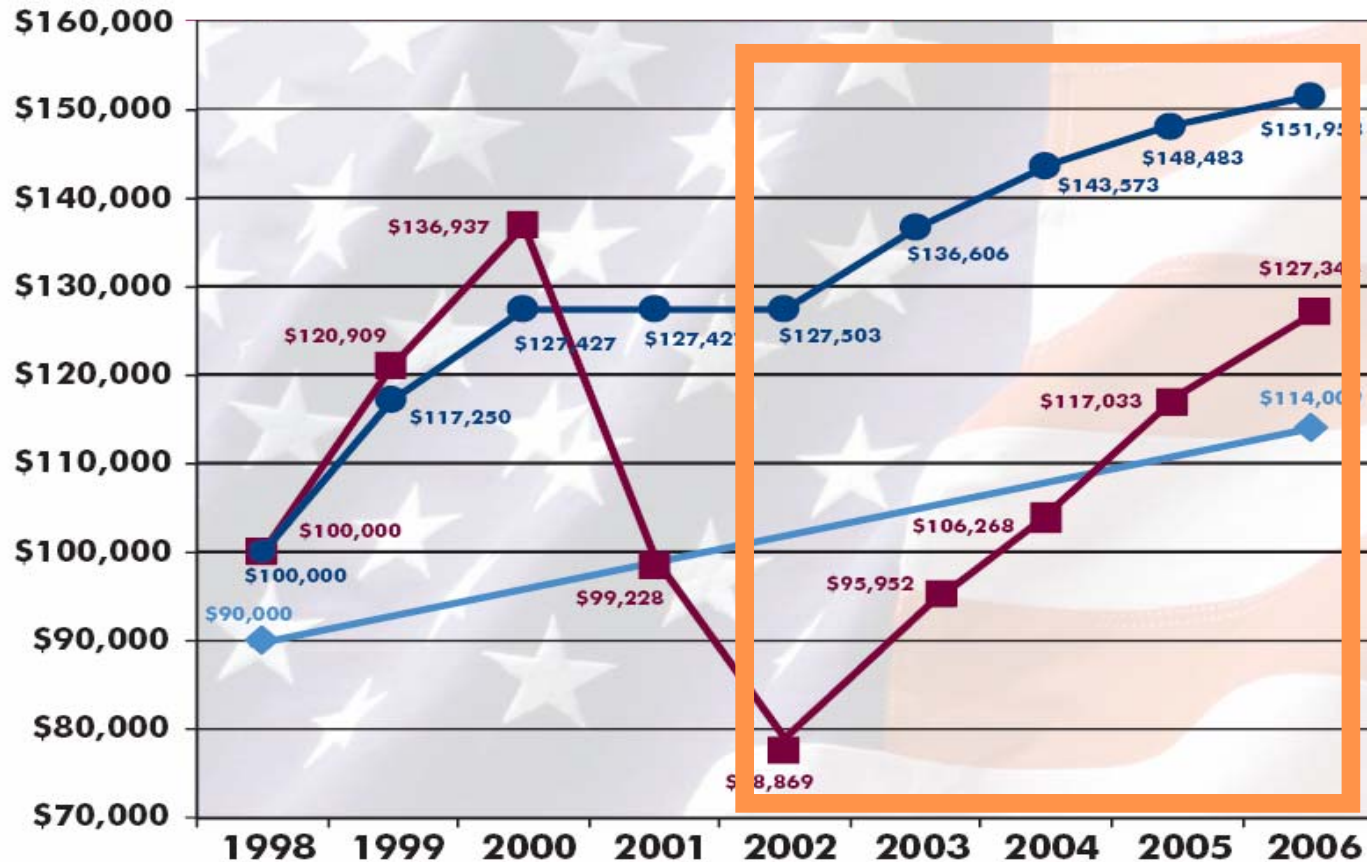
# Presenting an Index Annuity, *continued*

In a year that the stock market index decreases, the annuity credits no interest, but the annuity's value remains undiminished. Neither the principal nor any previously credited interest are lost.



# Presenting an Index Annuity, *continued*

When the stock market index once again increases, the annuity credits a portion of the index increase as interest. Notice that the index does not need to recover to its previous high before interest is credited.



# Presenting an Index Annuity, *continued*

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- What's the catch?
  - Time commitment
  - Every index annuity has surrender charges
  
- Why surrender charges?
  - They allow the company to credit more interest
  - But they can be completely avoided by the customer



# IRA Contribution Limits

# IRA Contribution Limits

## Who may contribute to an IRA?

- Anyone who receives taxable compensation (wages, salaries, tips, bonuses, commissions, taxable alimony, etc.) during a year may make an IRA contribution for that year
- A person's contribution is limited to the lesser of taxable income or the amount shown below:

Year	2007	2008
Age under 50	\$4,000	\$5,000
Age 50 or higher	\$5,000	\$6,000

- An IRA contribution for a given tax year can be made as late as April 15 of the following year

# IRA Contribution Limits, *continued*

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## Who may contribute to an IRA?, *continued*

- Husbands and wives may each have an IRA, even if one of them is not working
- Spousal IRA
  - An IRA funded by a married taxpayer in the name of his or her spouse who has less than the maximum allowable contribution limit in annual compensation
  - The couple must file a joint tax return for the year of contribution
  - The working spouse may contribute up to the maximum allowable annual contribution to both the Spousal IRA and his or her own IRA as well

# IRA Contribution Limits, *continued*

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## What about rollovers?

- Anyone who has money in a former employer's defined contribution retirement plan, such as a 401(k) plan, can roll that balance tax-free to a traditional IRA
  - There is no income limit
  - A rollover does not count against their contribution limits

# IRA Contribution Limits, *continued*

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## What is the tax treatment of an IRA?

- There is a choice of two types of IRA's: traditional or Roth
- Traditional IRA
  - Contributions are tax deductible under certain circumstances
  - Earnings are not taxed until withdrawn
- Roth IRA
  - Contributions are not tax deductible
  - Earnings are not taxed until withdrawn
  - Earnings are not taxed at all under certain circumstances



# How Traditional IRA's Work

# Traditional IRA's

## When are contributions to a traditional IRA tax deductible?

In a traditional IRA, contributions are tax deductible, except ...

- If the owner participates in an employer's qualified retirement plan on any day in the tax year, the deductibility of contributions declines to zero between certain adjusted gross income levels

Year	Single Filer	Joint Filer
2007	\$52,000 - \$62,000	\$83,000 - \$103,000

# Traditional IRA's, *continued*

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## When are contributions to a traditional IRA tax deductible?, *continued*

- A working spouse not covered by a retirement plan through employment may make a tax-deductible contribution to an IRA even if the other spouse does participate in an employer's qualified retirement plan
  - The deductibility of such contributions declines to zero between joint adjusted gross income levels of \$156,000 - \$166,000

# Traditional IRA's, *continued*

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- If a non-deductible contribution is made to a traditional IRA:
  - A portion of any withdrawal will not be taxed, but ...
  - IRS Form 8606 must be filed with your income tax return to report any non-deductible contributions and any withdrawals when they occur
  
- Should you make a non-deductible contribution to an IRA?
  - Generally, no, because a non-deductible contribution increases the record-keeping burden associated with the IRA
  - The same tax-deferral can be achieved through the purchase of a non-qualified annuity, and there are no contribution limits on a non-qualified annuity

# Traditional IRA's, *continued*

So, with a traditional IRA, I get the tax incentive that I can deduct my contribution from my taxable income

**32** IRA deduction

1	Wages, salaries, tips, etc. Attach Form W-2 here. Also attach Form W-2s and 1099-R if tax was withheld.	7	Taxable interest. Attach Schedule B if required.	13	Capital gain or (loss). Attach Schedule D if required. If not required, check here <input type="checkbox"/>
2	Dividend distributions	8	Tax-exempt interest. Do not include on line 8a.	14	Other gains or (losses). Attach Form 4797.
3	Ordinary dividends. Attach Schedule B if required.	9	Qualified dividends. Attach Schedule B if required.	15	IRA distributions
4	Taxable refunds, credits, or offsets of state and local income taxes (see page 24).	10		16a	IRA distributions
5	Alimony received	11		16b	IRA distributions
6	Business income or (loss). Attach Schedule C or C-EZ.	12		17	Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E.
7	Capital gain or (loss). Attach Schedule D if required. If not required, check here <input type="checkbox"/>	13		18	Farm income or (loss). Attach Schedule F.
8	Other gains or (losses). Attach Form 4797.	14		19	Unemployment compensation
9	IRA distributions	15		20	Social security benefits
10	Rentals and annuities	16a		21	Other income. List type and amount (see page 20).
11	Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E.	16b		22	Add the amounts in the far right column for lines 7 through 21. This is your total income.
12	Farm income or (loss). Attach Schedule F.	17		23	Adjusted Gross Income
13	Unemployment compensation	18		24	
14	Social security benefits	19		25	
15	Other income. List type and amount (see page 20).	20		26	
16	Add the amounts in the far right column for lines 7 through 21. This is your total income.	21		27	
17		22		28	
18		23		29	
19		24		30	
20		25		31	
21		26		32	
22		27		33	
23		28		34	
24		29		35	
25		30		36	
26		31		37	
27		32			
28		33			
29		34			
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31		36			
32		37			

Congress and the IRS gave us this tax incentive to encourage people to save for retirement.

Of course, when the IRS gives us a tax break, there are also rules.

The two keys rules regarding taking money out are:

- We are strongly discouraged to take money out prior to age 59½
- We are strongly encouraged to take money out every year starting at age 70½

# Traditional IRA's, *continued*

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## **Penalty tax for withdrawals prior to age 59½**

All withdrawals from a traditional IRA are subject to income taxes. In addition, any withdrawal prior to age 59½ from a traditional IRA is subject to a 10% penalty tax, unless the distribution:

- Occurs due to the owner's death
- Occurs while the owner is disabled
- Is one of a series of substantially equal periodic payments made over the life expectancy of the owner
- Is used to pay unreimbursed medical expenses in excess of 7½% of adjusted gross income
- Is used to pay medical insurance premiums after the owner has received unemployment compensation for more than 12 weeks
- Is used to pay the costs of a first-time home purchase (up to a lifetime limit of \$10,000)
- Is used to pay qualified higher education expenses for the owner or eligible family members
- Is used to pay back taxes because of an IRS levy placed against the IRA

# Traditional IRA's, *continued*

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## Mandatory distributions for traditional IRA's

- Distributions of certain minimum amounts must begin no later than April 1 of the year following the year the owner reaches age 70½
  - No contributions may be made to a traditional IRA after age 70½
- Failure to take minimum required distributions at that age results in a 50% excise tax on the required amounts that were not distributed
- As a result, most insurance companies compute the minimum required distributions on their annuities and communicate to clients that they should be taken

# Traditional IRA's, *continued*

## More about Minimum Required Distributions (**MRD's**):

- MRD's must begin no later than April 1 of the year following the year the owner reaches age 70½
- The MRD for a given year is the IRA's value as of December 31 of the preceding year divided by a life expectancy factor, a sampling of which are shown below:

Owner's Age	70	75	80	85	90
Life Expectancy Factor	27.4	22.9	18.7	14.8	11.4
Portion that Must Be Withdrawn	3.65%	4.37%	5.35%	6.76%	8.77%

- If the owner's spouse is the IRA's sole beneficiary and is more than 10 years younger than the owner, a joint life expectancy table can be used which will lower the MRD



# How Roth IRA's Work

# Roth IRA's

## What are the allowable contributions to a Roth IRA?

- Contributions to a Roth IRA are not tax deductible
- Annual contribution limits are the same as those shown previously, reduced by any contribution made to a traditional IRA
- Contributions may be made even after the owner reaches age 70½
- The annual contribution limit declines to zero between certain adjusted gross income levels

Year	Single Filer	Joint Filer
2007	\$99,000 - \$114,000	\$156,000 - \$166,000

- Roth IRA's do not have a minimum required distribution requirement starting at age 70½

# Roth IRA's, *continued*

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## What are the requirements for a distribution to be non-taxable?

A qualified (i.e. non-taxable) distribution is a withdrawal:

- That is made after the five taxable year period beginning with the tax year in which the owner first contributed to a Roth IRA, and
- That meets at least one of the following requirements:
  - Occurs after the owner attains age 59½
  - Occurs due to the owner's death
  - Occurs while the owner is disabled
  - Is used to pay the costs of a first-time home purchase

If a distribution does not meet one of the requirements above, earnings taken in the withdrawal are taxable. The 10% penalty tax also applies, with the same exceptions as for a traditional IRA.



# Which is Better?

Traditional IRA versus Roth IRA

# Which is Better?

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- If I am establishing a new IRA, which is better, a traditional IRA or a Roth IRA?
  
- The most accurate answer is:
  - If you expect your tax rate to be higher in retirement than your current tax rate, the Roth IRA is better for you
  - If you expect your tax rate to be lower in retirement than your current tax rate, the traditional IRA is better for you
  
- If your client has no firm opinion on this, then what follows is a helpful illustration

# Which is Better?, *continued*

**If I am establishing a new IRA, which is better?**

- Helpful illustration
  - You are a farmer
  - Would you rather pay taxes on the seeds or the crop?



## Which is Better?, *continued*

- Of course, it would be more advantageous to pay taxes on the seeds, since the seeds are much smaller than the crop
  - Take our earlier example of a 25-year-old who puts \$3,000 annually into an IRA for 40 years and earns 8% interest
  - Contributions =  $\$3,000 \times 40 \text{ years} = \$120,000$
  - Balance at age 65 = \$839,343
  - This person could withdraw \$69,034 annually over 30 years, for total withdrawals of  $\$2,071,020$
  - Would you rather pay taxes on \$120,000 or \$2,071,020?
- So, for most people, a Roth IRA makes more sense

# Which is Better?, *continued*

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- However, the traditional IRA remains more popular
  
- Why?
  - Many would rather have an immediate tax deduction rather than plan on saving taxes later
  - The traditional IRA may be the better solution depending upon your current tax rate versus your tax rate in retirement



# What is the Process for Establishing an Annuity as an IRA?

# Process

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## What is the process for establishing an annuity account as an IRA?

- Ensure that your client can make an IRA contribution based on the income limits and other limits discussed in this presentation
- Determine whether a traditional IRA or Roth IRA best fits your client's needs
- Provide product recommendations to your client and choose the annuity that best meets their needs and desires
- Fill out the application for the annuity, checking off the box on the application to indicate that it is a traditional IRA or Roth IRA



# IRA Rollover

# IRA Rollover

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## What is the sales opportunity for you, the agent?

- Anyone, from working age adults through retirees, who has changed jobs at some point in their career may have left behind money with their former employer's retirement plan, such as a 401(k) plan
- By leaving money in the former employer's plan, your client is giving up some degree of control and flexibility
  - Investment choices are limited to those available in the plan and certain investment choices, such as company stock, can be very risky
  - The former employer is probably not set up to provide an excellent level of customer service to your client's account
  - If the company fails, access to retirement funds could be in jeopardy

# IRA Rollover, *continued*

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## What is the sales opportunity for you, the agent?, *continued*

- **Help your clients take control of their retirement savings through an IRA (Individual Retirement Account) rollover**
  - Note: money in their current employer's plan must stay in that plan
  - Ask about any and all former employers – any money left in retirement plans at those employers are eligible for rollover
  - A 401(k) or similar retirement plan is often an individual's largest financial asset

# IRA Rollover, *continued*

Your clients have 3 options for employer-sponsored retirement plan funds when they leave a job:

## 1. Take a lump-sum distribution

- While this puts cash in their pockets, this is a bad idea because:
  - The distribution is subject to federal, state, and local income taxes, including a 20% withholding for federal taxes
  - Additionally, there is a 10% penalty tax if you are under age 59½
  - Depending upon their age, tax bracket, and state of residence, **taking a lump-sum distribution could cost them 50% or more of their retirement savings**
  - They must start over on building their retirement savings

# IRA Rollover, *continued*

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Your clients have 3 options for employer-sponsored retirement plan funds when they leave a job, *continued*:

## **2. Leave the money in their old employer's plan, or transfer it to their new employer's plan**

- A much better choice than a lump-sum distribution, but still with some disadvantages:
  - They are not in complete control of their money
  - Limited investment choices
  - Possibly poor customer service
  - Ask yourself: Five, ten, or twenty years from now:
    - How important will you be to your former employer?
    - Are you sure the company will be alive and solvent?

# IRA Rollover, *continued*

Your clients have 3 options for employer-sponsored retirement plan funds when they leave a job, *continued*:

## 3. Roll their funds over to an IRA

- Advantages
  - Continues the tax-deferred growth of their retirements savings
  - Allows them to take control of their savings and put it in the type of financial vehicles that best suit their needs and desires
  - Allows them to consolidate their retirement savings for easier management
  - Allows them to put their savings with a financial provider that is financially strong and set up to provide excellent customer service



# What is the Process for Establishing an Annuity as a Rollover IRA?

# Rollver IRA Process

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## What is the process for rolling retirement funds into an annuity?

- Provide product recommendations to your client and choose the annuity that best meets their needs and desires
- Fill out the application for the annuity, including the funds transfer form – **that's it, your part is done!**
- However, it is an excellent idea for you and the client together to call the former employer and ask:
  - “We would like to do a rollover to an IRA at an insurance company. Do you require any of your own forms to be filled out, or will you accept the insurance company’s transfer request?”
  - Often employers require the former employee to fill out a company-specific form, and this way you stay in control of the whole process

# Rollver IRA Process, *continued*

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## **What is the process for rolling retirement funds into an annuity?,** *continued*

- The annuity provider will send that transfer form to the former employer's retirement plan administrator
  - The former employer's retirement plan administrator will send the funds directly to the annuity provider – if they send the funds to you, immediately forward the check to the annuity provider
  
- This is called a “direct rollover”
  - A direct rollover is not subject to taxation and assures the continued tax preferential treatment of the funds

# Rollver IRA Process, *continued*

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## What is the process for rolling retirement funds into an annuity?, *continued*

- Can your clients make their ongoing annual IRA contributions to the rollover IRA?
  - Yes, if the rollover IRA accepts ongoing premiums and they are eligible to make an IRA contribution

# Rollver IRA Process, *continued*

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## In summary ...

- Ask your clients whether they have any retirement plan money sitting in a former employer's plan
- Show them the benefits of taking control of that money and placing it in an IRA
- Recommend an appropriate product to help them reach their financial goals
- The direct rollover process is easy and protects the tax-deferred status of their retirement savings



# IRA Conversion

# IRA Conversion

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## What is the sales opportunity for you, the agent?

- Most IRA money is in traditional IRA's
  - Most people establish traditional IRA's to get the immediate tax deduction
  - 401(k) rollover money also typically goes into traditional IRA's
- In many cases, you can create an illustration which shows that your client will enjoy a considerable higher after-tax income in retirement if that money were recharacterized as Roth IRA money
- This piques your clients' interest and enables you to also discuss the benefits of using various financial products to meet their goals

# IRA Conversion, *continued*

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## What is an IRA conversion?

- Changing an established traditional IRA account into a Roth IRA
- This may, but does not necessarily, entail moving the money from one account to another

## Why would I want to do this?

- To get the beneficial tax treatment of Roth IRA's going forward on the IRA balance

# IRA Conversion, *continued*

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## Why would I not want to do this?

- The entire balance of the IRA is treated as taxable income in the year the conversion is made
  - Besides the large tax bill this produces, it may put you into a higher tax bracket and/or reduce the amount of deductions you can take for mortgage interest, giving to charity, etc.
- If a withdrawal is made from the IRA in order to pay the taxes, there is a 10% penalty tax on the withdrawal if it is made prior to age 59½
- If you move money from one account to another to do this, you may incur surrender charges or other charges on the existing account

# IRA Conversion, *continued*

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**If these obstacles are significant, what is the most palatable way to make an IRA conversion?**

- Make it steadily over time, that is, convert a portion of the traditional IRA into a Roth IRA steadily over a period of years
- This will require rolling the money from one account into another, because one account cannot be treated as partially traditional and partially Roth

# IRA Conversion, *continued*

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## In summary ...

- Ask your clients whether they have any money in a traditional IRA
- Show them the benefits of converting that money into a Roth IRA
- Recommend an appropriate product to help them reach their financial goals
- Make sure they thoroughly understand the tax implications of the transaction



# More on the Appeal of Annuities as IRA's

# The Appeal of Annuities as IRA's

**So, if an IRA can be:**

- A certificate of deposit at a bank
- Holdings of stock at a brokerage house
- An account at a mutual fund company
- Or a variety of other things

**... why would I want it to be an annuity at an insurance company?**

# The Appeal of Annuities as IRA's, *cont'd*

## Reason #1: **Safety**

- All annuities protect and guarantee your principal, subject only to a surrender charge, which is an avoidable charge
- There is a secondary level of protection provided by the state guaranty association
  - In Utah, the state guaranty association provides protection for up to \$200,000 of annuity cash value
  - For more details, see the website of the National Organization of Life and Health Guaranty Associations ([www.nolhga.org](http://www.nolhga.org))
- If a customer has a complaint against the carrier and wants to get a regulator involved, that regulator is located here in Utah

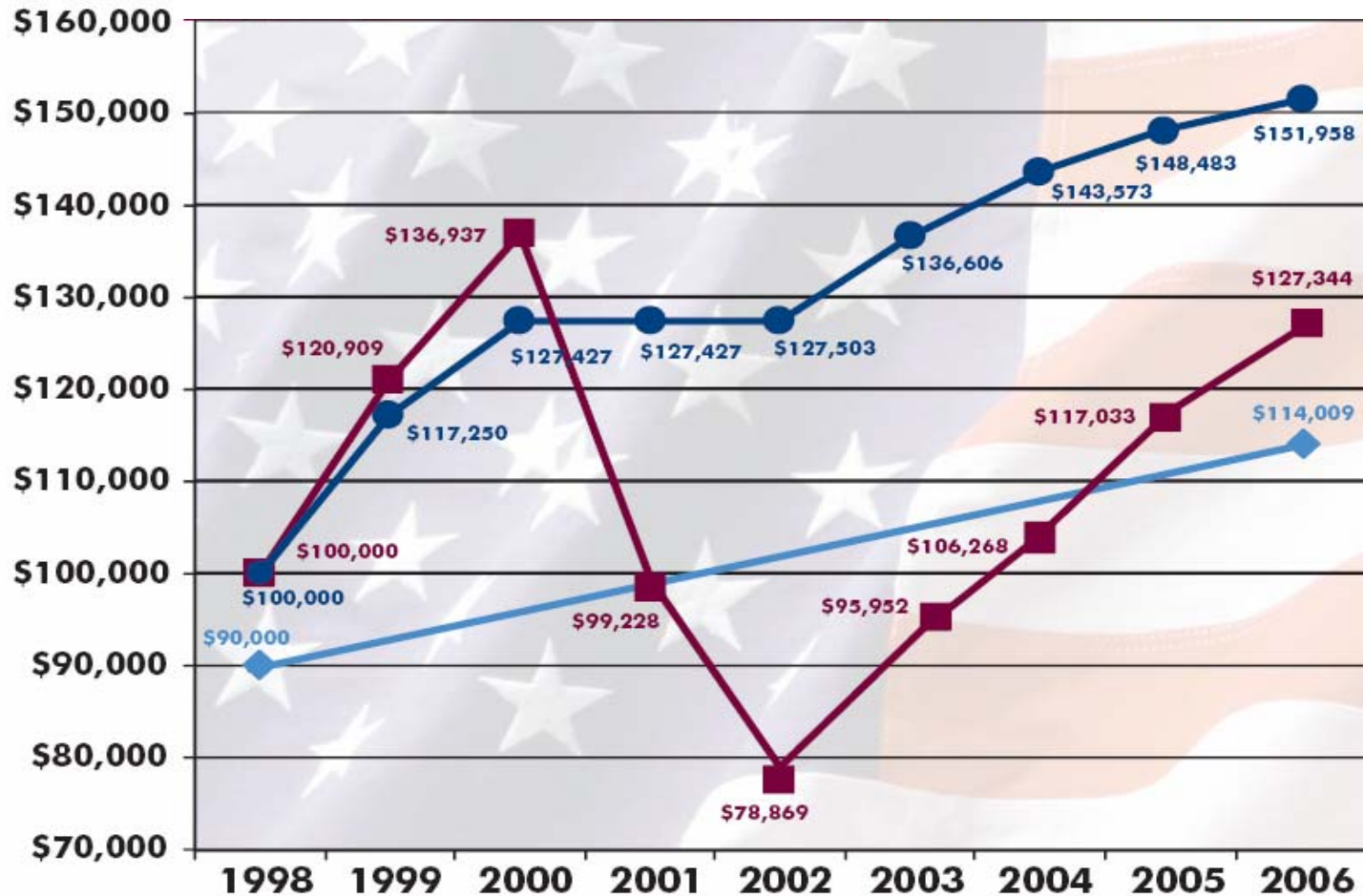
# The Appeal of Annuities as IRA's, *cont'd*

## Reason #2: **Yield**

- Some annuities credit an interest rate set by the company, and the rate is typically higher than the interest rates available on CD's, savings accounts, or money market funds
- Some annuities credit an interest rate that is tied to the performance of a stock market index, and these exciting annuities offer excellent upside potential without risk to principal

# The Appeal of Annuities as IRA's, *cont'd*

Remember our illustration using this chart:



# The Appeal of Annuities as IRA's, *cont'd*

## Reason #3: **The Right Amount of Liquidity**

- All annuities have surrender charges, but during the surrender charge period, annuities allow for periodic penalty-free partial withdrawals and often provide for a waiver of the surrender charge for certain hardships
- The surrender charge is avoided by taking no withdrawals in excess of the penalty-free partial withdrawal allowance until the surrender charge period is over
- Frankly, if you are withdrawing more than the penalty-free partial withdrawal amount annually, you are drawing down your retirement savings too fast

# The Appeal of Annuities as IRA's, *cont'd*

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- Why do annuities have surrender charges?
  - To allow the insurer to invest in long-term bonds and other long-term investments in order to deliver a higher yield to the consumer
  
- What provisions are typical for allowing penalty-free partial withdrawals?
  - Withdrawals of accumulated interest
  - Withdrawals of 10% of the account value
  - A larger penalty-free withdrawal in the event of nursing home confinement or diagnosis of terminal illness
  - Elimination of surrender charge at death

# The Appeal of Annuities as IRA's, *cont'd*

## Reason #4: **Lifetime Income**

- Annuities provide options for guaranteed lifetime income, similar to a pension plan
- Unlike a certificate of deposit at a bank, holdings of stock at a brokerage house, or an account at a mutual fund company ...
- The account balance of an annuity at an insurance company can be converted into a fixed, guaranteed income stream that can continue for your choice of:
  - The rest of a person's life
  - The rest of two persons' lives, typically a married couple
  - A guaranteed period of time



# Multi-Generational IRA

# Multi-Generational IRA

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## What is the sales opportunity for you, the agent?

- Per a February 2004 study by Prudential Financial:
  - 6 in 10 retirees view their entire nest egg as a safety net and derive their retirement income solely from Social Security and pension checks
  - Most retirees' primary focus for their accumulated savings is to preserve or even continue to grow their assets
- Nearly every retiree with accumulated savings in a IRA would be interested in an approach which:
  - **Costs them nothing** (i.e. there is no cost nor loss of flexibility)
  - But which **creates a legacy** for their children and/or grandchildren by lessening the tax burden on any remaining IRA funds at death
- This piques your clients' interest and enables you to also discuss the benefits of using various financial products to meet their goals

# Multi-Generational IRA, *continued*

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## How does it work?

- Any traditional (non-Roth) IRA can be a multi-generational IRA
  - The key is in how the beneficiaries are set up and in the choices the beneficiaries make when they inherit the IRA
  
- With a traditional IRA, distributions of certain minimum amounts (called “Minimum Required Distributions” or “MRD’s”) must begin no later than April 1 of the year following the year the owner reaches age 70½
  - By properly setting up beneficiaries today, when the beneficiaries inherit the IRA, they can also take minimum required distributions rather than cashing out the IRA in full
  - This preserves the tax deferral of the IRA and potentially decreases income taxes and estate taxes on the IRA

# Multi-Generational IRA, *continued*

## Reminders about MRD's:

- MRD's must begin no later than April 1 of the year following the year the owner reaches age 70½
- The MRD for a given year is the IRA's value as of December 31 of the preceding year divided by a life expectancy factor, a sampling of which are shown below:

Owner's Age	70	75	80	85	90
Life Expectancy Factor	27.4	22.9	18.7	14.8	11.4
Portion that Must Be Withdrawn	3.65%	4.37%	5.35%	6.76%	8.77%

- If the owner's spouse is the IRA's sole beneficiary and is more than 10 years younger than the owner, a joint life expectancy table can be used which will lower the MRD

# Multi-Generational IRA, *continued*

## How to make an IRA multi-generational:

Owner	Beneficiary	MRD's Based On
Husband	Wife	Husband's Life Expectancy

↓  
**At Husband's death, Wife elects to be treated as the owner, MRD's are recalculated**

Owner	Beneficiary	MRD's Based On
Wife	Son	Wife's Life Expectancy

↓  
**At Wife's death, Son becomes the owner, MRD's are reduced**

Owner	Beneficiary	MRD's Based On
Son	Son's Child	Son's Life Expectancy

# Multi-Generational IRA, *continued*

## How to make an IRA multi-generational, *continued*:

Owner	Beneficiary	MRD's Based On
Son	Son's Child	Son's Life Expectancy



**If Son dies prior to living out his life expectancy, Son's Child becomes the owner**

Owner	Beneficiary	MRD's Based On
Son's Child	Son's Grandchild	Remaining Life Expectancy of Son as if He Were Alive

# Multi-Generational IRA, *continued*

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## Mistakes to avoid:

- Naming a beneficiary who is not an individual, such as the owner's estate
  - The entire IRA will need to be distributed (and therefore taxed) within 5 years
  
- Naming multiple individuals as beneficiaries
  - The MRD will be calculated based on the beneficiary with the shortest life expectancy, which results in the IRA being distributed earlier than necessary
  - Suggestion: if the beneficiaries have widely differing ages, set up multiple IRA's, each IRA with one beneficiary

# Multi-Generational IRA, *continued*

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## **Mistakes to avoid, *continued*:**

- Beneficiaries choosing to cash out the IRA rather than take MRD's
  - Beneficiaries certainly have the right to do this, but federal estate taxes and income taxes could cause them to lose up to 70% or more of the value of the IRA
  
- Also, in case the beneficiary dies prior to the owner and the owner does not think to notify the carrier to update his beneficiary designations, it is always a good idea to name a contingent beneficiary

# Multi-Generational IRA, *continued*

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## **An illustration of the power of a multi-generational IRA:**

- Suppose John, age 60, has \$100,000 in his IRA and has named his wife Catherine, age 55, as his beneficiary.
  - John begins taking MRD's at age 70½.
  
- When John dies at age 75, Catherine, who is now age 70, elects to be treated as the owner. Catherine names her son Bob, age 35, as her beneficiary.
  - Catherine takes MRD's based on her life expectancy.

# Multi-Generational IRA, *continued*

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## An illustration of the power of a multi-generational IRA, *continued*

- When Catherine dies at age 85, Bob, who is now age 50, takes the remaining IRA balance and establishes an inherited IRA. He names his daughter Christina as his beneficiary.
  - Because his MRD's are based on his life expectancy, the MRD's and their associated tax burden are reduced, the IRA distribution period is extended, and more of the IRA assets continue to grow on a tax-deferred basis.
  
- When Bob dies at age 75, Christina can continue to take MRD's based on Bob's remaining life expectancy as if he were still alive.
  - She can also name her own beneficiary.

# Multi-Generational IRA, *continued*

## An illustration of the power of a multi-generational IRA, *continued*

- Assuming an earned interest rate of 8% on the IRA and no change to today's tax laws, John's **\$100,000** IRA:
  - Will have provided benefits to **his wife, his son, and his granddaughter**
  - Will have provided **\$2.7 million** in total distributions
  - Money will remain in the IRA for **50 years** after John's death

# Multi-Generational IRA, *continued*

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## In summary ...

- Ask your clients whether they have an IRA that will minimize their beneficiary's tax burden at death and provide a legacy of income to their children and grandchildren
- Help them to properly structure their IRA accounts and beneficiary designations
- If this requires establishing new financial accounts, the direct rollover process is easy and protects the tax-deferred status of their retirement savings



# Summary and Conclusion

# Summary

## In summary ...

- It is becoming more and more important for people to save for retirement
- IRA's were created by Congress to give people a tax incentive to save for their retirements
- Annuities have features that make them very appealing in an IRA
- The rules surrounding IRA's are relatively complex, so make sure you refer your client to a qualified tax professional
- See IRS Publication 590, Individual Retirement Arrangements, for more details



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