



# Q: Can My Beneficiaries Avoid Paying Income Taxes on My Annuity When I Pass Away?

## A: Definitely YES!

By Bill Monte

I continue to find that most owners of fixed or variable annuities lack knowledge about the taxation of their annuities after they pass away. I see some very surprised faces looking back at me when I tell them it is their annuity beneficiaries who will be socked with paying the income taxes on the gain built up in their annuities over the years and not them. I am referring specifically to annuities owned outside of an IRA.

Very often I meet with annuity owners who never intend to withdraw money from their annuities to supplement their retirement income. The income generated from their Social Security, pension, minimum IRS distribution (RMD) from their IRA or 401K account and interest from other investments is sufficient to give them a very comfortable standard of living. Owners simply plan on leaving the annuity to their beneficiaries upon their passing. This is known in the annuity industry as a "Legacy Asset."

There is a strategy I implement quite often with clients that gives them tremendous peace of mind. With this strategy, their beneficiaries (usually the children) are guaranteed to inherit the annuity 100% income-tax free and at a substantially larger amount. This annuity tax planning strategy works well for both married couples, as well as single individuals (widows/widowers). The best way for me to explain the implementation of this strategy would be by describing an actual client case of a couple who has taken advantage of it for their situation.

When John and Mary were in their late 50's, they received a \$100,000 inheritance from Mary's mother which they decided to deposit into a fixed annuity. Now in their early 70's, their annuity has accumulated nicely over the years and is currently valued at \$200,000. They have been very happy with this safe investment as it has paid them a fixed and guaranteed interest rate each year with no risk to their principal. In addition, they have been able to defer the income taxes on all of the interest earned over the years.

John and Mary had never given much thought to what would happen to their annuity after they both passed away. They always figured they might someday withdraw money from the annuity to help supplement their retirement income. They now realize their other sources of income have been sufficient to keep them quite comfortable. Their intention now is to find the most effective way to pass their annuity on to their two adult children and through them, their four grandchildren.

Here is what John and Mary decided to do with their existing annuity to help their children avoid the large income tax liability they will be burdened with if they were to inherit the taxable annuity from their parents. The planning strategy, called Annuity Maximization, simply involves converting their annuity to life insurance instead, which is the only option available that guarantees their children will inherit an amount that is not only substantially larger than the value of their annuity, but also passes to the children completely income-tax free through the life insurance benefit. The conversion is either done all at once or over 5-10 years, depending on the amount of taxable gain that has built up inside of the annuity over the years.

In John and Mary's case, we decided to convert their annuity to tax-free life insurance over a 5-year period by "annuitizing" the annuity over that timeframe. The after-tax annual payments they receive from their annuity over those five years are repositioned into the life insurance policy each year. After the 5th year, no further life insurance payments would be required and the annuity would be completely converted.

They are both currently 73 years old, the tax-free amount immediately created from the life insurance policy was \$600,000, over 3 times as much as their current \$200,000 annuity! In conclusion, instead of the children inheriting John and Mary's \$200,000 annuity and having to pay income taxes on the \$100,000 gain, they instead are guaranteed to inherit \$600,000 completely income tax-free! This annuity conversion strategy perfectly met their objectives and created a much better situation for their children.

I look forward to thoroughly educating existing annuity owners on this common legacy planning strategy in help them determine if it is appropriate for them to consider within the context of their specific objectives and overall estate plan. A review of your existing annuities is the first step in this exploratory process.

If you would like to learn more about the Annuity Maximization planning strategy, please feel free to contact me at 585-721-2385. Also look for my monthly informational group discussion that I give at the Brighton Recreation Center in this magazine's Event Calendar.

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Are you doing everything you can be doing?**

### Ask Yourself...

- Have I done everything I can to maximize the legacy I leave to my loved ones by minimizing the taxes that they will pay?
- Am I aware of all available ways to protect my assets from the high cost of nursing home care?
- Should I explore long-term care insurance? Trusts?
- Will some of my assets have to go through Probate? What can I do to prevent it?
- How can I use my IRA accounts to create a substantial tax-free estate for my children and grandchildren?

**Call 721-2385 to schedule a discussion**

Free Monthly Estate, Legacy and Long-Term Care Planning  
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