

Advanced Markets Matters

Taxation of Annuity Distributions

A Financial Professional's Guide



Updated for
SECURE 2.0



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Taxation of Annuity Distributions: Introduction

Taxes Impact Retirement Income Planning

Income taxation plays an important role in retirement income planning. To encourage taxpayers to save for retirement in qualified plans, 403(b) plans and IRAs, as well as in nonqualified annuities, our government provides certain tax advantages.

The tax advantages include:

- Exclusion of contributions to qualified plans and 403(b) plans
- Possible deduction of contributions to traditional IRAs
- Tax-deferred growth for many plans and nonqualified annuities
- Potentially tax-free growth for Roth IRAs and Roth 401(k) designated accounts

The Internal Revenue Code (IRC) also includes certain deterrents to ensure retirement dollars are used for retirement. Thus, it penalizes taxpayers who take retirement funds too early or too late.

Tax Rules: Not All Created Equal

Many rules for qualified and nonqualified annuities are similar. Yet they are not the same. They are usually found in different IRC sections. They can differ significantly. It's important to both understand them and, in light of them, consider strategies that can help clients address retirement income goals.



The Annuity Advantage

Consider annuities as a key element in a retirement income playbook. Annuities stand out as one of the only financial products able to guarantee an income stream that cannot be outlived. They may also offer protection against market volatility, creditors and spendthrifts.

Understanding How Distributions are Taxed

Distributions from various qualified retirement plans are generally taxable as ordinary income. Sometimes plan amounts can be included in income even when there has been no distribution. For example, such “deemed distributions” include pledging an IRA as security for a loan, acquiring “collectibles” within an IRA or defaulting on a loan from a qualified plan.

Planning Opportunity

Tax Diversification: Now. Later. Never.

In considering retirement income strategies, tax diversification may rival asset diversification in importance. While many retirement assets grow tax deferred, sometimes it may be beneficial to pay some taxes sooner rather than later.

- › A portfolio overweighted in “tax-me-later” investments, combined with the possibility of higher tax rates in the future, could yield reduced income in retirement.
- › Nontaxable and tax-advantaged investments – sometimes referred to as “tax-me-never” investments, such as Roth IRAs and life insurance – may make sense.

History shows that tax rates change over time. Future tax policies are unknown. Converting to a Roth IRA for tax-free growth may make sense for retirees and even pre-retirees seeking to take advantage of any years of lower-than-normal tax exposure. Protecting tax-free income with a Roth IRA annuity can provide a hedge against future tax uncertainty.

Life insurance on traditional IRA owners can provide funds for a surviving spouse to pay taxes on the conversion of the decedents’ traditional IRAs to Roth IRAs. Life insurance on qualified plan and 403(b) plan participants can do the same for spouse and non-spouse beneficiaries who wish to convert such accounts to inherited Roth IRAs.

Traditional IRAs

In determining the taxability of distributions from traditional IRAs, all of an individual's traditional IRAs must be aggregated.

If only deductible contributions have funded all of an individual's traditional IRAs (i.e., all pre-tax contributions), then each distribution is fully taxable. If after-tax contributions have funded any of the individual's traditional IRAs, then each distribution will be part taxable and part a return of basis.

The amount of any traditional IRA distribution that should be excluded from income during a taxable year is calculated using an annuity exclusion ratio. The amount excluded is calculated by dividing the amount of nondeductible contributions (i.e., basis or investment in the contract) not yet recovered by the sum of the total account balance as of year end plus all distributions and any outstanding rollovers. This amount is then multiplied by the amount of all distributions during the year.



Example: Barry has three traditional IRAs, valued at \$20,000, 50,000 and \$120,000 as of year-end. Over the years, Barry contributed \$20,000 after-tax (i.e., nondeductible) to the IRA valued at \$50,000. During the year, Barry took two distributions of \$5,000 each, in May and September. Barry's basis of \$20,000 is divided by \$200,000 (the year-end value of all three IRAs plus the total distribution amount of \$10,000). The resulting exclusion ratio of 10% ($\$20,000/\$200,000$) is multiplied by the total amount of distributions of \$10,000. Thus, \$1,000 is excludable as a return of basis and \$9,000 is includable in income.

Unfortunately, Barry's after-tax contributions can be easily excluded from income only if he tracked his after-tax contributions by filing Form 8606 in the years such contributions were made or distributed.

Distributions from traditional IRAs before age 59½ are subject to a 10% early distribution penalty unless an exception applies.

A Note About Qualified Plans and 403(b) Annuities

Similar to traditional IRAs, if no funds in a qualified plan or 403(b) annuity have already been taxed to the participant (e.g., after-tax contributions or the cost of life insurance in a qualified plan), then the entire distribution is generally considered ordinary income.* Taxation of distributions from qualified plans and 403(b) annuities is complex and beyond the scope of this guide.

*Special rules apply in the case of certain lump sum distributions to individuals who turned age 50 before 1986 and lump sum distributions of employer stock.

Roth IRAs

Taxation of a distribution from a Roth IRA depends on whether the distribution is qualified and, if not, whether the distribution amount is from regular contributions, conversion amounts or earnings. Generally, distributions of regular contributions to a Roth IRA are not taxable.

Qualified distributions from a Roth IRA are not includable in income or subject to the 10% early withdrawal penalty. To be a qualified distribution, the distribution must satisfy two requirements — a holding period and a triggering event:

- First, the distribution must occur after the fifth tax year for which a contribution was made to any Roth IRA of the owner.
- Second, the distribution must satisfy one of four triggering events regarding the taxpayer:
 - becoming a first-time homebuyer (\$10,000 lifetime limitation)
 - turning age 59½
 - becoming totally disabled
 - dying

Insight: For Roth IRA funding made in the following year for the previous year (i.e., before the due date for filing the individual's tax return for the previous year), the five-taxable-year period begins in the previous year.

If the distribution is made to a beneficiary after the death of the owner, the period held by the decedent is included in the period held by the beneficiary to determine whether the five-taxable-year period is satisfied.

Insight: If any required minimum distribution (RMD) must be taken before the end of the five-taxable-year period, the distribution would not be a qualified distribution. The 10% early distribution penalty would not apply however, as the distribution would be made on account of death.

A nonqualified distribution is defined as any distribution that is not qualified. Nonqualified distributions from Roth IRAs are treated as made in the following order:

- First from regular contributions to the Roth IRA (regular contributions can be withdrawn tax- and penalty-free at any time).
- Next from conversion contributions on a first-in first-out (FIFO) basis. Thus, the distribution is treated as coming from the first converted amount that was includable in income, and then from the nontaxable part, if any, of that converted amount (i.e., after-tax contributions). This process is repeated for each conversion, in the order made.
- Last from earnings on the regular Roth IRA contributions and conversions.

Similar to traditional IRAs, all of an individual's Roth IRAs must be aggregated for purposes of applying the ordering rules.

Unless an exception applies, nonqualified distributions from Roth IRAs are subject to the 10% early distribution penalty to the extent that the distribution is includable in income. The penalty may also apply in the case of a nonqualified distribution attributed to an earlier conversion — even if the current distribution itself is not taxable.

This five-taxable-year holding period applicable to conversion contributions differs from the five-taxable-year period applicable to determining whether a Roth IRA distribution is qualified. The five-taxable-year holding period applicable to conversion contributions begins in the taxable year of the conversion. A new holding period begins with each conversion.



*Example: Sue established a Roth IRA with \$5,000 in 2017. She contributed \$5,000 more in 2018. She converted a \$20,000 deductible IRA in 2020. In 2023, at age 55, she withdrew \$15,000. Even though Sue met the holding period requirement, the withdrawal was not a qualified distribution because she did not meet any of the four triggering events. Thus, the nonqualified distribution is first treated as a return of her \$10,000 of regular contributions and then of \$5,000 from her 2020 conversion. Because no exception to the early distribution penalty applies and it has been less than five years since the conversion, the \$5,000 from the 2020 conversion **is subject to the 10% early distribution penalty, even though the entire distribution is nontaxable.***

Insight: The complexity of the taxation of nonqualified Roth IRA distributions can frustrate taxpayers and cause costly mistakes. Roth IRA owners should be advised to save all Forms 5498 (IRA Contribution Information), 1099-R and 8606 (Nondeductible IRAs) and consult their tax advisor before making any withdrawals.

Nonqualified Annuities

Nonqualified annuities are purchased with funds that were already taxed (i.e., premiums are not tax deductible). The owner receives a tax basis in the annuity. Often referred to as the investment in the contract, it essentially equals total premiums paid (minus any amounts already received tax free).

How that investment in the contract is recovered depends on whether the amount is considered an “amount received as an annuity” or an “amount not received as an annuity”

Amounts **not** received as an annuity include:

- Partial withdrawals, generally including systematic withdrawals, and
- Loans, assignments or pledges

These amounts are generally taxed under a last-in-first-out (LIFO) basis.* As such, they are includable in income as ordinary income to the extent there is gain in the contract. Thus, gain is recovered before investment in the contract.

Likewise, amounts received upon the complete surrender or redemption of an annuity are includable as ordinary income to the extent there is gain in the contract. However, if such payments are made in installments, then the payments are not includable in income until the investment in the contract has been fully recovered.

In determining the amount includable in income, all annuity contracts issued by the same insurance company to the same owner during any calendar year are treated as one contract.

Amounts received as an annuity generally refer either to annuity payouts under an immediate annuity or payouts from a deferred annuity contract that has been annuitized. Investment in the contract is recovered pro rata from each payment. An exclusion ratio is calculated by dividing the investment in the contract by the expected return. Once the entire investment in the contract has been recovered, each annuity payment is taxed in full.

The chart on the following page highlights some of the distribution differences between traditional IRAs, Roth IRAs, Roth 401(k) accounts and nonqualified annuities.

*Different rules may apply with respect to investment in a contract before August 14, 1982.

Distribution Differences

Quick Reference by Plan Type			
Traditional IRA	Roth IRA	Roth 401(k) Account	Nonqualified Annuity
Required to comply with RMD rules at age 73*	No lifetime RMDs	Required to comply with RMD rules applicable to qualified plans, during life and at death; after 2023, no lifetime RMDs	No lifetime RMDs; required distributions on death of owner/holder
Earnings tax deferred	Earnings potentially tax free	Earnings potentially tax free	Earnings tax deferred
All traditional IRAs are aggregated for tax purposes	All Roth IRAs are aggregated for tax purposes	Roth 401(k) accounts are not aggregated for tax purposes	Only nonqualified annuities purchased from the same company in the same year are aggregated for tax purposes
Distributions not previously taxed are fully taxed on distribution; if after-tax contributions included, taxed on a pro-rata basis	Qualified distributions tax-free; nonqualified distributions of regular contributions can be received tax- and penalty-free; nonqualified distributions of conversions may incur penalty and of earnings may incur tax and penalty	Qualified distributions tax-free; nonqualified distributions are taxed on a pro-rata basis	Amounts not received as an annuity taxed on LIFO basis (i.e., gains first); amounts received as an annuity are taxed partially as a return of basis and partially as gain (using an exclusion ratio)
No qualified distribution	To determine whether a distribution is qualified, any Roth IRA must be five-years old	To determine whether a distribution is qualified, particular Roth 401(k) account must be five-years old (credit for prior years in another plan is available if rolled over from one plan to another**)	No qualified distribution
No qualified distribution	To determine if a distribution is qualified there are four triggering events: age 59½, death, disability or a first-time home buyer exception	To determine if a distribution is qualified there are three triggering events: age 59½, death or disability	No qualified distribution

*Age 72 if turned 72 before 2023 and after 2019.

**For a rollover between designated Roth 401(k) accounts. A rollover to a Roth IRA starts a new five-taxable-year period.

Too-Early Distributions

Distributions from qualified plans, 403(b) plans, IRAs and nonqualified annuities before age 59½ may be subject to an additional 10% penalty tax (25% in the case of SIMPLE IRAs in the first two years). The penalty tax applies to the amount includable in income. Some exceptions to the penalty exist. See below for an overview of them.

Early-Distribution-Penalty Exceptions		
72(q) – Nonqualified	72(t) – IRA	72(t) – Qualified Plan
Age 59½	Age 59½	Age 59½
Death	Death	Death
Disability	Disability	Disability
Series of substantially equal periodic payments (SOSEPP)	SOSEPP	SOSEPP
Allocable to investment in the contract before August 14, 1982	Made to an owner for medical care, but not in excess of the amount deductible by the owner under IRC Section 213 for amounts paid during the year for medical care (determined without regard to if the owner itemizes deductions for the year)	Made to an owner for medical care, but not in excess of the amount deductible by the owner under IRC Section 213 for amounts paid during the year for medical care (determined without regard to if the owner itemizes deductions for the year)
Immediate annuity contract*	Made to pay qualified higher education expenses during the taxable year for the taxpayer, the taxpayer's spouse or the child or grandchild of the taxpayer or the taxpayer's spouse	Made to an employee after separation from service after attainment of age 55 (lesser of age 50 or 25 years of service if public safety employee, private sector firefighter or state/local corrections officer)
Qualified funding asset	Made to unemployed individuals for the payment of health insurance premiums	Made to an alternate payee under a qualified domestic relations order
Any payment made from an annuity purchased by an employer upon termination of a qualified plan and held by the employer until the employee's separation from service	Qualified first-time homebuyer distribution up to \$10,000 (lifetime limit); not available if the withdrawal qualifies for another exception	Dividends paid with respect to stock of a corporation (ESOPs only)
	Contributions withdrawn before due date (earnings are subject to penalty)	Return of certain excess contributions
	Qualified reservist distribution	Qualified reservist distribution (limited to elective deferral portion)
	Made on account of certain IRS levies against the plan	Made on account of certain IRS levies against the plan
	Qualified disaster recovery distribution made within 180 days of disaster (\$22,000 lifetime maximum and principal residence must be located within federally declared disaster area)	Qualified disaster recovery distribution made within 180 days of disaster (\$22,000 lifetime maximum and principal residence must be located within federally declared disaster area)
	Qualified birth or adoption distribution up to \$5,000**	Qualified birth or adoption distribution up to \$5,000**
	Terminal illness (death expected within 84 months)**	Terminal illness (death expected within 84 months)**
	Domestic abuse (limited to lesser of \$10,000 or 50% of vested account balance); effective for distributions after 2023**	Domestic abuse (limited to lesser of \$10,000 or 50% of vested account balance); effective for distributions after 2023**
	Emergency personal expense distribution (limited to \$1,000 each year but limited to one every three years unless repaid or aggregate elective deferrals and employee contributions equal or exceed the amount of the distribution)**	Emergency personal expense distribution (limited to \$1,000 each year but limited to one every three years unless repaid or aggregate elective deferrals and employee contributions equal or exceed the amount of the distribution)**
		Emergency savings account (ESA) distribution (but contributions to such accounts limited to \$2,500)
		Distributions to pay certain long-term care premiums (limited to \$2,500 each year); effective for distributions after 12/29/2025

*In the case of a 1035 exchange, the purchase date of the new contract is considered to be the date upon which the deferred annuity was purchased for purposes of the 10% penalty tax; thus, the immediate annuity exception does not apply.

**Subject to certain requirements, distributions may be recontributed to a rollover eligible retirement plan within three years.

Insight: A surviving spouse not yet 59½ should not execute a spousal rollover if there is any chance of needing the money before age 59½. The exception for death is available only if the account remains in the name of the deceased owner.

Insight: Individuals should not rollover funds in their qualified plan or 403(b) annuity into an IRA if they separated from service in the year they attained age 55 and before age 59½ if there is any chance of needing the money before age 59½. The “separation from service at age 55” exception is unavailable to IRA owners.

SOSEPP Exception to Too-Early Distributions

One exception in particular is a useful planning tool to eliminate the 10% penalty tax in cases where accessing funds before age 59½ simply cannot be avoided. It is the “series of substantially equal periodic payments” (or “SOSEPP”) exception. While often termed the 72(t) exception, exceptions to the penalty applicable to qualified plans, 403(b) plans and IRAs are all found in IRC Section 72(t). This exception is also found in Section 72(q) with the other exceptions applicable to nonqualified annuities.

Essentially, the SOSEPP exception provides that the early distribution penalty will not apply to any part of a series of substantially equal periodic payments made at least annually for:

- the life or life expectancy of the individual or
- the joint lives or joint life expectancies of the individual and their designated beneficiary

If the series is modified before the later of five years or age 59½, then the exception to the penalty is retroactively revoked. In that event, the penalty and interest are owed for all payments made before age 59½.

Planning Opportunity

Fix It and Forget It with a SPIA

The rules for satisfying the SOSEPP exception are complicated. The tax consequences of a mistake can be drastic (penalties and interest going back to the first payment in the series). A lifetime qualified or nonqualified single premium immediate annuity (SPIA) with no increasing payout option may satisfy the requirements for a SOSEPP exception to the 10% early distribution penalty and allow the owner to “fix it and forget it.”

Design Opportunities Using SOSEPP

Choice of size. An owner can determine the size of the IRA from which to take the SOSEPP distributions by using rollovers* or trustee-to-trustee transfers. The IRA aggregation rule does not apply for purposes of satisfying the SOSEPP exception. IRAs can be split into smaller IRAs or combined into a larger IRA to achieve the desired payment. Nonqualified annuities may not be as readily split or combined as the 1035 exchange rules must be satisfied.

Choice of IRS-approved method. The IRS provides three methods for determining periodic payment amounts:

1. RMD Method: Produces the smallest payment, but is the easiest. Simply divide the account balance by the appropriate life expectancy factor from the Single Life table, the Joint and Survivor Life table or the Uniform Lifetime table. Payments are recalculated annually.
2. Amortization Method: Produces the largest payment. The periodic payment is determined by amortizing the account balance in level amounts using a reasonable rate of interest and life expectancy from the Single Life table, the Joint and Survivor Life table or the Uniform Lifetime table. Payments, once calculated, never vary.
3. Annuitization Method: Produces a payment slightly less than the amortization method. The account balance is divided by an annuity factor derived using a specified mortality table and a reasonable interest rate. Payments, once calculated, never vary.

When using either the amortization or the annuitization method, an owner or participant has a one-time option, in any year after the first year, of switching to the RMD method.

Modifications. Payments can be modified after the later of five years or age 59½. Payments can then be reduced, increased or stopped entirely. **Caution:** It is critical that the SOSEPP not be modified before the later of five years or age 59½, other than for death or disability. The five-year period starts on the date of the first payment of the series and does not end until the fifth anniversary of the date of that first payment. Therefore, DO NOT:

- stop the payments early
- take an extra payment
- add to the amount in the IRA by contribution, rollover or transfer

Transfers, rollovers and exchanges after 2023 will not be treated as modifications as long as the amount of the payments remain the same (whether from one or more accounts).

*Only one IRA-to-IRA rollover (check made out to the IRA owner) is permitted within any 12-month period.

Too-Late Distributions

Distributions from qualified plans and traditional IRAs must generally begin at RMD age or, if earlier, death. Distributions from Roth IRAs must begin upon the death of the owner. Rules for these required minimum distributions (RMDs) are in IRC Section 401(a)(9) and its accompanying regulations. Distributions from nonqualified annuities are not required during lifetime, but are required upon death. Rules for required distributions from nonqualified annuities on the death of the holder are in IRC Section 72(s). While the rules may be similar, key differences must be taken into account.

	RMD Age
Born in 1950	Remains at 72
Born 1951-1959*	73
Born 1960 & later*	75

*Technical correction needed to reflect Congressional intent.

Traditional IRAs and Qualified Plans – During Lifetime

Starting at a traditional IRA owner's required beginning date (RBD), the entire interest in the IRA must be distributed to the IRA owner over the life of such owner or over the lives of such owner and a designated beneficiary (or over a period not extending beyond the life expectancy of such owner or the life expectancies of such owner and a designated beneficiary). The IRA owner's RBD is April 1 of the year following the year the IRA owner attains RMD age. The rules are generally the same for participants in a qualified plan except the participant's RBD may be delayed if the participant continues to work past RMD age and holds a 5% or less ownership interest in the employer. In that case, the RBD is April 1 of the year following the year the participant retires.

Insight: Qualified plan participants who own 5% or less of the business and plan on working past RMD age can delay their RMDs — provided the plan allows deferrals beyond that age. Leaving assets in the plan, as opposed to rolling them over to an IRA, will relieve the need to take RMDs until April 1 of the year following the year the participant retires.

RMDs from IRAs and qualified plans not annuitized are calculated using the life expectancy method. Using this method, the amount that must be distributed each year is determined by dividing the account balance as of December 31 of the prior year by a life expectancy factor taken from the appropriate table. The appropriate table is the Uniform Lifetime table unless the sole beneficiary of the account is the owner's spouse and the spouse is more than 10 years younger than the owner. In that case, the correct table is the Joint and Survivor table. It will produce larger factors and thus smaller RMDs.

The Uniform Lifetime table is entered using the owner's age as of December 31 of the distribution year. The first distribution year is the year the owner attains RMD age. The owner has until April 1 of the year following the year they attain RMD age to take their RMD for their first distribution year. The RMD for every distribution year thereafter must be taken by December 31. If the owner waits until April 1 of the following year (their RBD) to take their RMD for their first distribution year, they must take a second RMD by December 31 of that same year. For purposes of determining the amount of the RMD for the second and future distribution years, the appropriate table is re-entered each year using the age of the owner as of the end of that calendar year (the "attained age" method).

Planning Opportunity

Fix It and Forget It with a SPIA

A different set of rules apply to funds in IRAs and defined contribution plans that are “annuitized.” The IRS generally considers the purchase of an immediate annuity to satisfy any RMD obligation provided the annuity is not payable over a period extending beyond the life expectancy of the IRA owner (and, if applicable, designated beneficiary) and meets certain other requirements.

Annual calculations are not required. And, payments from IRA-SPIAs may reduce the amount of RMDs needed to be taken from non-annuitized IRA funds*.

Joint IRA Income for Two

Transferring all or a portion of an IRA into an IRA-SPIA can offer protected lifetime income for an owner and their spouse.

- A joint-and-survivor annuity with a spouse who is an IRA owner’s sole beneficiary satisfies the RMD and minimum distribution incidental benefit rules, regardless of the spouse’s age.

Insight: Taking more than the RMD in one year doesn’t count toward the RMD for the next. The excess distribution will however lower the account balance used for determining the next year’s RMD.

NEW Planning Opportunity: IRA-SPIA Payments Now Count

SECURE 2.0 provides that payments from annuitized IRA funds can be added to payments from non-annuitized IRA funds to meet RMD requirements. The value of any annuitized IRA contracts on 12/31 of the prior year can be added to the 12/31 prior year account balance of all non-annuitized IRAs to calculate the RMD. Then the annuitized payments can be added to the RMDs taken from the non-annuitized accounts.



*Example: Jason, who is 75 in 2023, had an account balance of \$738,000 on 12/31/22. He also has an IRA-SPIA that pays \$2,000 a month (\$24,000 annually). **Pre-SECURE 2.0**, Jason would have had an RMD of \$30,000 ($\$738,000/24.9$) from the non-annuitized funds plus the \$24,000 IRA-SPIA payments for a total RMD of \$54,000. **Post-SECURE 2.0**, he can add together the account values in calculating a “total required amount” and then subtract the annuity payments from it. Adding \$286,300** to the non-annuitized value of \$738,000 equals \$1,024,300. Dividing by 24.9 gives a total required amount of \$41,368. Subtracting \$24,000 (the annuity payments) from that amount means Jason must take only \$17,368 from his non-annuitized funds.*

* SECURE 2.0, Section 204.

**Based on purchase of new SPIA at current age and paying same amount.

Distributions: Upon Death

The first SECURE Act drastically changed RMD rules upon death, effective for deaths after 2019.

Eligible Designated Beneficiaries

The ability to stretch distributions over a beneficiary's lifetime is available only to eligible designated beneficiaries:

- Spouses
- Disabled beneficiaries
- Chronically ill beneficiaries
- Minor beneficiaries
- Beneficiaries not more than 10 years younger than the deceased IRA owner or plan participant

Spouses can also continue to rollover such accounts into their own IRA or plan account (see next page). Minors may stretch the payments until age 21* then are subject to the 10-year rule. Eligible designated beneficiaries generally are determined as of the date of death.

Distributions over the eligible designated beneficiary's lifetime must begin before 12/31 of the year following the death of the owner/participant and must be made at least annually thereafter.

For non-spouse eligible designated beneficiaries, the age of the eligible designated beneficiary as of 12/31 of the year after the death of the individual determines the Single Life Table factor used to calculate the RMD for that first year. Thereafter, 1 is subtracted from that original factor each year to determine the RMD (the reduction method).

Alternatively, eligible designated beneficiaries of decedents who died before their required beginning date (RBD) may withdraw the entire account balance by 12/31 of the year that contains the 10th anniversary of the IRA owner's or plan participant's death.



Non-Eligible Designated Beneficiaries

All other designated beneficiaries – i.e., non-eligible ones – are subject to the 10-year rule. Thus, such beneficiaries must withdraw their share of any IRA or qualified plan benefits by 12/31 of the year that contains the 10th anniversary of the IRA owner's or plan participant's death. There are no annual RMDs. However, if the decedent died on or after their RBD, such beneficiaries must also take annual stretch distributions during years 1-9.**

A trust may be a permitted designated beneficiary if it meets certain requirements.

Designated beneficiaries are determined as of 9/30 of the year after the year of the individual's death. Any non-individual beneficiaries may be paid out before this deadline to retain the 10-year deferral (versus the five-year deferral) for any remaining designated beneficiaries.

Non-Designated Beneficiaries

Rules for non-designated beneficiaries – estates, charities and non-see-through trusts – are unchanged. The distribution period is limited to five years if the owner/participant died before their required beginning date or to the owner/participant's remaining life expectancy if otherwise.

Special Rules for Surviving Spouses

1. Any surviving spouse who is a designated beneficiary may elect to rollover the decedent's IRA or plan account into their own IRA or plan account.
2. A surviving spouse who is the sole designated beneficiary of the decedent's IRA may elect to treat the decedent's IRA as their own.
3. In the case of the decedent dying before their RBD, the surviving spouse who is the sole beneficiary may delay taking RMDs from the inherited IRA or plan account until the deceased spouse would have turned RMD age.
4. If the surviving spouse is the sole beneficiary and holds the decedent's IRA or plan account as an inherited plan, the surviving spouse uses the attained age method and re-enters the Single Life Table each year.
5. Spousal beneficiaries of Roth IRAs who rollover or treat the decedent's Roth IRA as their own are not required to take RMDs during their lifetime.

*Proposed Reg. §1.401(a)(9)-4(e)(3).

**Proposed Reg. §1.401(a)(9)-5(d)(1)(i).

Remember: Aggregation Rules Differ

Qualified Plans: RMDs must be calculated **for** each separate qualified plan and distributed **from** each separate plan.

Traditional IRAs: RMDs must also be calculated separately for each IRA; however, an individual generally may total the amount of RMDs from each IRA but then take the total amount from one or more IRAs. Exceptions:

- IRAs held as an owner cannot be aggregated with IRAs held as a beneficiary
- IRAs held as a beneficiary can be aggregated with other IRAs inherited from the same decedent only

Planning Point: No Rollovers for Non-Spouse Beneficiaries

A non-spouse beneficiary of a qualified plan or IRA is prohibited from rolling over an inherited account into their own name. They may, however, do a trustee-to-trustee transfer of such funds to an inherited IRA account that is titled as such – in the name of the decedent for the benefit of the beneficiary. RMDs must continue to be taken from the new inherited account.

Planning Opportunity: Transfers Available to Non-Spouse Beneficiaries

Qualified Plans and IRAs	Nonqualified Deferred Annuities
While a non-spouse beneficiary is prohibited from rolling over an inherited account into their own name, they may do a trustee-to-trustee transfer of such funds to an inherited account that is titled as such — in the name of the decedent for the benefit of the beneficiary. RMDs must be taken from the new inherited account.	A private letter ruling* permitted a non-spouse beneficiary to execute a 1035 exchange of an inherited nonqualified deferred annuity to another nonqualified deferred annuity. The non-spouse beneficiary must continue to take required distributions under the new inherited annuity, continuing to use the reduction method.

*A PLR may not be used as precedent and applies only to the taxpayer requesting the ruling.

Nonqualified Annuities – Upon Death

Distributions required on the death of the holder of a nonqualified annuity also vary by when the holder dies and who are the designated beneficiaries. If the holder of a nonqualified annuity dies:

- Before the annuity starting date (generally the first day of the first period for which an amount is received as an annuity), then the entire contract must be distributed within five years of the holder's death — unless there is a designated beneficiary.
- On or after their annuity starting date, the contract must be distributed at least as rapidly as under the method used by the holder — unless there is a designated beneficiary.

If there is a designated beneficiary, then distributions may be made over the life or life expectancy of the designated beneficiary as long as the distributions begin within one year of the holder's death. If the designated beneficiary is the surviving spouse of the holder, then the surviving spouse is treated as the holder of the contract. Separate account rules apply when there are multiple designated beneficiaries under a nonqualified annuity contract, allowing each natural-person designated beneficiary to stretch out payments over their lifetime.

When the holder of the annuity contract is a non-natural person, such as a trust, the holder of the annuity is deemed to be the primary annuitant. Thus, the death of the annuitant will trigger the required distributions. If a trust is the beneficiary of the annuity contract, the longest period of time that the annuity death benefit payout can be deferred is five years from the annuitant's date of death.

Planning Opportunity

Fix It and Forget It with a Nonqualified SPIA

The 1035 exchange of a nonqualified deferred annuity by a designated beneficiary for a SPIA will satisfy IRC Section 72's required distributions as long as the annuity is payable over the lifetime of the designated beneficiary. Annual calculations are not required.

Distributions at Death: Quick Reference

IRA	Nonqualified Annuity
Death before Required Beginning Date (RBD)	Death before Annuity Starting Date (ASD)
<p>Spouse as sole designated beneficiary may:</p> <ul style="list-style-type: none"> ➤ treat as their own, ➤ rollover to their own IRA, or ➤ treat as inherited IRA <p>If treat as inherited IRA, may</p> <ul style="list-style-type: none"> ➤ take RMDs over lifetime beginning by 12/31 of year following year of death of IRA owner (or 12/31 of year decedent would have turned age 72), using the attained age method, or ➤ take entire account by 12/31 of year containing the fifth anniversary of owner's death <p>Eligible non-spouse designated beneficiary may:</p> <ul style="list-style-type: none"> ➤ take RMDs over lifetime beginning by 12/31 of year following year of death of IRA owner, using the reduction method, or ➤ take entire account by 12/31 of year containing the fifth anniversary of owner's death <p>Non-eligible designated beneficiary (generally non-disabled adult children) must take their entire share before 12/31 of the year that contains the 10th anniversary of the death of IRA owner</p>	<p>Spouse as designated beneficiary becomes the contract holder and can select own beneficiary</p> <p>Non-spouse designated beneficiary may</p> <ul style="list-style-type: none"> ➤ take required distributions over lifetime* beginning within one year of death of annuity owner, or ➤ take entire account by fifth anniversary of annuity owner's death
Death after RBD	Death after ASD
<p>Spouse as sole designated beneficiary may:</p> <ul style="list-style-type: none"> ➤ treat as their own, ➤ rollover to their own IRA, or ➤ treat as inherited IRA and take RMDs over lifetime beginning by 12/31 of year following year of death of IRA owner, using the attained age method <p>Eligible non-spouse designated beneficiary may:</p> <ul style="list-style-type: none"> ➤ take RMDs over their lifetime beginning by 12/31 of year following year of death of IRA owner (or IRA's owner lifetime, if longer), using the reduction method <p>Non-eligible designated beneficiary (generally non-disabled adult children) must take annual stretch distributions during years 1-9 and distribute the remaining amount before 12/31 of the year that contains the 10th anniversary of the death of IRA owner</p>	<p>Spouse becomes the contract holder and can select own beneficiary</p> <p>Non-spouse designated beneficiary may take required distributions over their lifetime* beginning within one year of death of annuity owner (or annuity owner's lifetime, if longer)</p>

*A private letter ruling approved three methods for a non-spouse beneficiary to satisfy the lifetime distribution requirements of Code section 72(s): amortization calculation method, annuitization calculation method, or RMD calculation method. A PLR may not be used as precedent and applies only to the taxpayer requesting the ruling.

Getting Started

The transition from saving for retirement to income generation during retirement encompasses safeguarding assets and seeking their tax-efficient and tax-effective distribution.

Retirement confidence and dignity comes from clients knowing that they'll always have a steady, stable income, no matter how long they live. Annuities can create such an income — one that's guaranteed to last a lifetime.

Need assistance discussing taxation of distributions? We can help.



Western & Southern: Our Strength. Your Future.

**Financial
Strength**

**1888
Heritage**

Built on a heritage dating to 1888, Western & Southern Financial Group (Western & Southern) today stands strong. As a dynamic family of diversified financial services providers, Western & Southern has demonstrated resolve and resiliency throughout challenging economic cycles. Our financial strength continues to be the cornerstone of our success. We are proud of our strong industry ratings, which you can check at WSFinancialPartners.com/ratings. Western & Southern remains committed to helping safeguard your future well-being with our strength, stability and full range of risk management financial solutions.

WSFinancialPartners.com

Annuities are issued by Integrity Life, National Integrity Life or Western-Southern Life Assurance Company. Integrity Life Insurance Company, Cincinnati, OH operates in DC and all states except NY, where National Integrity Life Insurance Company, Greenwich, NY, operates. Western & Southern Life Assurance Company operates in DC and all states except NY. W&S Financial Group Distributors, Inc. (doing business in CA as W&S Financial Insurance Services) is an affiliated life insurance agency of the issuer. Issuer has sole financial responsibility for its products. All companies are members of Western & Southern Financial Group.

Interest rates are declared by the insurance company at annual effective rates, taking into account daily compounding of interest. Riders are optional and contain additional cost. Diversification may not protect against market risk. Payment of benefits under the annuity contract is the obligation of, and is guaranteed by, the insurance company issuing the annuity. Guarantees are based on the claims-paying ability of the insurer. Product approval, availability and features may vary by state. Earnings and pre-tax payments are subject to income tax at withdrawal. Withdrawals prior to age 59½ are generally subject to a 10% IRS penalty tax.

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