

Optimizing an annuity for a client who is “set for life”

Thanks to good financial planning advice, you may have clients with more income than they’ll need in retirement. These clients may now be considering the most efficient way to pass some of their assets on to their loved ones. Variable universal life may offer a more efficient strategy than other options.

Meet Tom, 65¹

He’s in excellent health and has more money than he can spend in retirement.

Current situation: He has a deferred annuity (currently worth \$1 million in cash value with \$700,000 in total cost basis) that he no longer needs for income.

Goal: To find a tax-efficient way to pass the annuity on to his children.

Financial considerations: He and his children are all in the top marginal tax bracket.

This is a hypothetical example for illustrative purposes only. Actual results may vary.



Some options to consider²

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| <h3>1 Annuity hold</h3> <p>Leave the annuity to his children, and they receive the death benefit when Tom passes away.</p> | <h3>2 Annuity to brokerage</h3> <p>Surrender the annuity and invest in a nonqualified brokerage account.</p> | <h3>3 Annuity to life</h3> <p>Take distributions from the annuity over time to purchase life insurance.</p> |
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¹ There are many factors that need to be considered in a situation like Tom’s, including the charges, future annuity guarantees and amount of gain in the annuity, the client’s health and tax bracket, the beneficiaries’ tax bracket and the payout option they choose after inheriting the annuity. A change to any of them could influence the option that makes the most sense. Also, these options are based on our assumptions and are not intended to imply that they’re the only ones available.

² We made a number of assumptions when calculating these scenarios, including that Tom will pass away at age 90, that the annuity no longer has a contingent deferred sales charge (CDSC), that the beneficiaries choose a lump-sum payout of the annuity, that Tom is over age 59½ and will avoid the 10% premature distributions tax and that Tom receives 7% growth after investment management fees but before protection fees and M&E charges for the annuity, life insurance and brokerage account. The growth in the brokerage account consists of 5.6% capital appreciation, 0.7% from ordinary interest and dividends and 0.7% from qualified dividends, and that there’s a 10% portfolio turnover on the brokerage account. Also, the brokerage account is taxed at 37% on ordinary income, 3.8% on net investment income and 20% on capital gains.

3 options for Tom to consider

1 Annuity hold

Tom can choose to keep the annuity, name his children as the beneficiaries and allow the annuity to accumulate until his death without taking distributions during his lifetime.

PLAN ADVANTAGES

- + Tom owes no additional taxes
- + The plan is already in place

PLAN DISADVANTAGES

- There's no step-up in basis at death
- The tax burden shifts to his children
- The beneficiaries must begin taking distributions soon after the owner's death

2 Annuity to brokerage

The next option would be to surrender the annuity and put the after-tax amount into a nonqualified brokerage account to invest in capital assets such as stocks, mutual funds or exchange-traded funds (ETF).

PLAN ADVANTAGES

- + Capital assets receive a step-up in basis at death
- + The beneficiaries aren't required to take distributions from a nonqualified brokerage account at the owner's death

PLAN DISADVANTAGES

- Tom will have to pay another \$122,400³ in taxes this year because he realized all the gain in the annuity when he surrendered it
- He may be giving up other annuity income and death benefit guarantees

3 Annuity to life

Another option would be to take partial surrenders of the annuity each year for 7 years, which is a commonly used funding strategy for life insurance, and put the after-tax amount (\$137,500) into a permanent life insurance policy.

PLAN ADVANTAGES

- + The beneficiaries would have immediate access to over twice the amount available in the other 2 scenarios in the first year if Tom passes away unexpectedly
- + The death benefit passes income tax-free to the beneficiaries

PLAN DISADVANTAGES

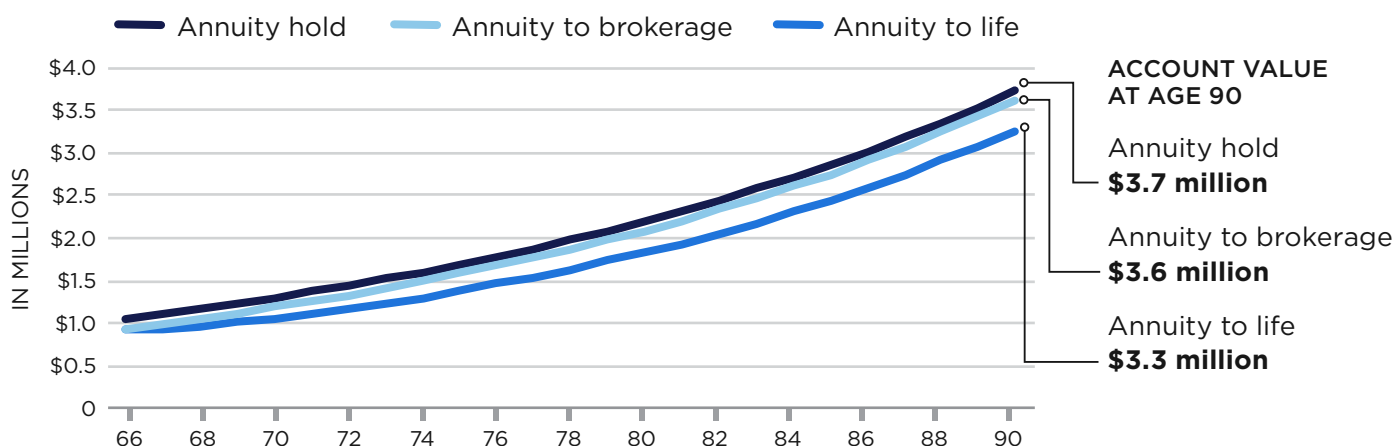
- Tom will owe \$81,400 in taxes in the first year
- He may be giving up other annuity income and death benefit guarantees

³ Tom's tax rate is 37%, and the 3.8% Medicare surtax would also apply because his income is over \$250,000 as a married filing jointly taxpayer. A full surrender of the annuity means he has realized \$300,000 of ordinary income (\$1 million contract value - \$700,000 cost basis). Applying the combined marginal rate of 40.8% to the \$300,000 of investment income means from the annuity's gain results in \$122,400 of income tax (\$300,000 x .408 = \$122,400).

Comparing the strategies

Effect on account value

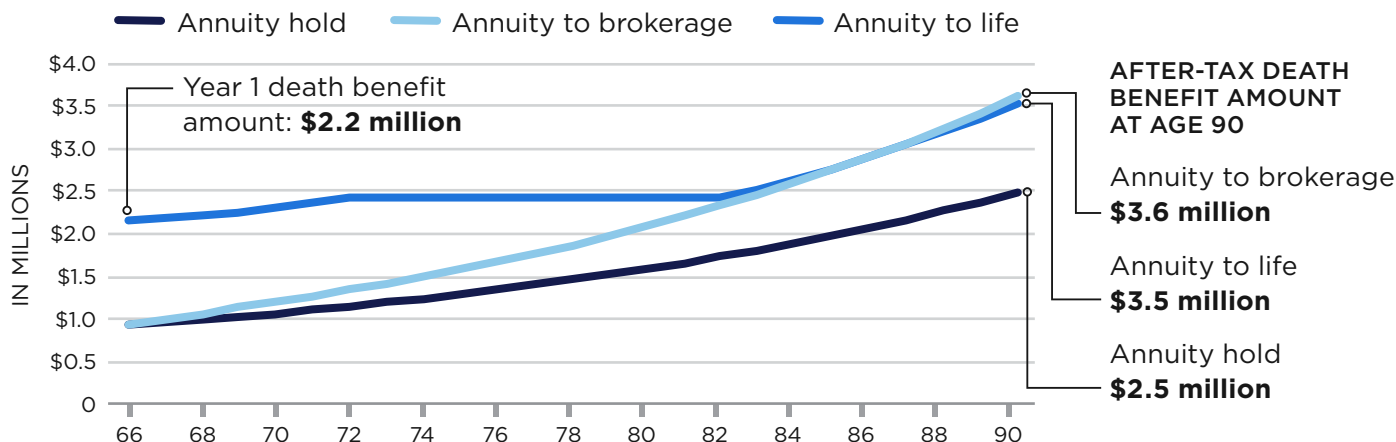
Normally, sales loads and surrender charges on life insurance would reduce the amount of money available to manage. But if Tom purchases a Nationwide Advisory Variable Universal Life product, as compared to traditional life insurance, it has neither surrender charges nor sales loads, which could potentially leave more money to manage. The taxes on the annuity would also be spread out over 7 years, so the cash surrender value is very similar in all years to the brokerage account.



This hypothetical example is for illustrative purposes only.

After-tax death benefit value

By leveraging the existing annuity for wealth transfer purposes, both the annuity to life and the annuity to brokerage strategy offer a significant increase in the value of Tom's legacy. **But only the annuity to life strategy offers an immediate and material step up in the amount available for wealth transfer should something happen to Tom.**



This hypothetical example is for illustrative purposes only.



The bottom line

What's good for retirement planning might not be efficient for wealth transfer. If clients want to make the most of the amount they leave their loved ones, converting an annuity that's subject to ordinary income taxes to an asset that can be accessed tax free at death, such as permanent life insurance, may make sense.



Find out whether this strategy could be right for your clients.

For more information or immediate assistance, contact your wholesaler or the **Life Insurance Solutions Center at 1-800-321-6064.**



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