Estate planning and wealth transfer

Annuity/IRA maximization

The concept

This is a technique for converting the value of a deferred annuity or IRA into a more tax-efficient legacy for heirs using an irrevocable life insurance trust (ILIT) and a life insurance policy.

Benefits

This concept can be used to effectively minimize income and estate taxes on an annuity or IRA that the owner does not want or need while maximizing the amount of wealth transferred to heirs.

Tax considerations

- Annuities are included in the owner's gross estate and increase the owner's estate tax exposure
- They do not receive a "step-up" in basis at the owner's death for income tax purposes
- Annuity payments to the decedent's beneficiary are characterized as "income in respect of a decedent" and taxed as ordinary income

Steps

1. The owner takes distributions from the annuity or IRA and pays income taxes on the distributions
   - Annuity distributions may be subject to a surrender charge
   - A 10% early withdrawal federal tax penalty may be imposed, unless an exception applies
2. The owner establishes an ILIT
3. The owner gifts the after-tax distributions from the annuity/IRA to the ILIT
4. If the use of the annual gift tax exclusion is desirable, the trustee sends Crummey notices to ILIT beneficiaries
5. Using the gifted after-tax annuity distributions, the ILIT purchases, owns and is the beneficiary of a life insurance policy on the grantor
6. Upon the grantor's death, the trustee collects the death proceeds both income and estate tax free
7. The death proceeds are used to benefit trust beneficiaries, pursuant to the terms of the ILIT

How it works