ANNUITIZING A TRADITIONAL IRA

Traditional IRAs are "spend-down" accounts and may be a great source of lifetime income. How can you help clients determine if annuitizing some—or all—IRA assets is a good option for them?

IRAs are often a source of retirement income for many clients. Since traditional IRAs must be spent down during retirement, it may be a good idea to consider how an annuity might be an attractive option to fulfill their guaranteed retirement-income needs.

Annuitizing all or part of a traditional IRA may be a viable strategy for clients interested in:

- **Guaranteed lifetime income.** If clients are concerned about outliving their income resources and needing to adjust their lifestyles, additional guaranteed lifetime income can help reduce that risk.
- **IRAs as primary income sources.** For many clients, a traditional or Roth IRA is a significant source of retirement income. As they also have required minimum distributions (RMDs), it may make sense to use traditional IRAs for additional guaranteed income via annuitization.
- **RMD management.** After the Setting Every Community Up for Retirement Enhancement (SECURE) Act 2.0, the annuitized portion of a traditional IRA can help manage the RMDs for the remaining assets within the account.
- **Continuous asset investment.** Typically, a retiree with guaranteed income sources—such as Social Security retirement benefits, a pension, and/or guaranteed lifetime income—will find it easier to keep remaining assets invested for growth, as monthly expenses are covered by those income sources.

Regardless of their motivations, clients often ask one common question regarding annuitizing their traditional IRAs: How will it affect RMDs? Let's consider two different scenarios.

1. Full Annuitization of a Traditional IRA

This is a straightforward scenario. Generally, once annuitized, the annuity is excluded from the value of the IRA for purposes of calculating RMDs. If the entire value of the IRA is annuitized, the annuity payments will be assumed to fulfill the RMD amount required going forward. This will be true for the life of the traditional IRA owner.

2. Partial Annuitization of a Traditional IRA

Partial annuitization raises an interesting issue, as RMDs usually start as a modest percentage and increase each year. On the other hand, the annuitized portion of a traditional IRA provides level payments. In any year, this means that some portion of the annuitized payment may be more than the RMD required for the value of the assets annuitized.

If a retiree annuitizes a portion of an IRA, there are now two accounts: The annuitized portion and the remaining account balance. Each of these must meet the RMD requirement. The annuitized portion of the account will cover its own RMDs, but what about any excess amount over the RMD? Can that excess be used to cover part of the RMD for the remaining account?

After the SECURE Act 2.0, the answer is yes. Any annuity payments that exceed the RMD for the annuitized portion may be aggregated with other distributions to satisfy RMDs for all IRAs. Think of it this way: A retiree annuitizes $300,000 of a $1,000,000 traditional IRA. Annual RMDs are still required for the remaining $700,000. The account owner can consider the total RMD required for both accounts and potentially offset that amount by the annuitized payment. This may reduce the distribution needed from the non-annuitized account. **This change applies to all IRAs annuitized after 12/31/22**. The IRS will provide additional guidance on the specifics of this calculation, but a retiree can use a good faith interpretation until then.

Clients Not Ready to Annuitize Yet?

Don't worry! For retirees concerned about needing additional funds in their later years, a qualified longevity annuity contract (QLAC) may be a good choice. A QLAC allows the client to defer RMDs (and the associated taxes) on up to $200,000 of qualified assets in exchange for a longevity hedge. The QLAC payments must begin by age 85, but for a retiree with longevity concerns, a QLAC can create the income needed later in life.

Of course, each client's situation is unique. It is important for clients to work with legal and tax professionals to determine what might be appropriate.

Actions You Can Take Right Now

- Find clients with traditional IRAs who may benefit from additional lifetime income.
- Determine if a full or partial annuitization might benefit those clients.
- Schedule time to review the options and help clients achieve improved outcomes.

Additional Resources and Links

Annuitizing? Consider Using Your "Spend-Down" Accounts

The Longevity Lesson from Social Security

Ages and Stages

For more information about retirement planning, please contact our Retirement Strategies Group at RSG@PacificLife.com or (800) 722-2333, ext. 3939.

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