ANNUITIZING? CONSIDER USING THE "SPEND DOWN" ACCOUNT(S)

Predictable retirement income can allow retirees improved confidence as they spend their savings. For many retirees, the largest asset they have is a traditional IRA, and this "spend down" account might be suitable for annuitization.

Many clients need additional predictable income to cover their essential expenses. For some, annuitizing a portion, or all, of a traditional IRA can be a good option. Traditional IRAs must begin distributions during the owner's lifetime. Annuitization can create predictable income and a consistent 1099, helping retirees gauge their tax bills.

Why might traditional IRAs be considered a "spend down" asset? The IRS requires that a traditional IRA begin distributions—regardless of whether they are wanted or needed—by age 72 (with limited exceptions). Since the Setting Every Community Up for Retirement Enhancement (SECURE) Act limited stretch IRAs to 10 years for most beneficiaries, more retirees may use their traditional IRAs for income and pass nonqualified step-up assets to the next generation(s).

Here are three questions that can help determine whether annuitization might work for a client.

1. Is the Need for Income Temporary or Permanent?

Annuitization tends to work best when income is needed for a determinable period, such as a period of years or a life expectancy. While life or joint-life options are available, the popular payout options are life or joint-life with a period certain or cash refund. Which option to use depends on the circumstances.

- Temporary income need. Clients who want to delay claiming Social Security benefits may want a period certain payout option to bridge the gap between when they retire and when they claim Social Security retirement benefits.
- Permanent income need. Clients with a permanent income gap might prefer a life expectancy payout option. Life or joint-life with period certain as well as life or joint-life with cash refund both allow the client to have lifetime income and assure that beneficiaries receive any unused premiums.

Remember, most non-spousal beneficiaries must receive all assets by the end of the 10^{th} calendar year after the year of the owner's death. If annuitizing, be sure that the insurance company can support that requirement.

2. What Is the Client's Tax Situation?

Annuitization payments from non-Roth accounts typically result in ordinary income to the IRA or qualified account owner. If the contact is a fixed, single-premium immediate annuity (SPIA), the plus is that the payments are consistent, which means there is a known taxable amount each year. This may be helpful for clients who want a more predictable 1099.

3. How Might the Payments Affect Required Minimum Distributions (RMDs)?

The annuitized IRA (or portion thereof) is not counted in the RMD formula. If the entire IRA is annuitized, then the annual payments will address any RMDs. If there are other non-Roth IRA qualified accounts, the client must still take RMDs from those accounts.

In many cases, the client will annuitize only a portion of the IRA assets. In this case, the annuitized stream of payments addresses the RMDs for the annuitized assets only. If there are other traditional IRA or qualified accounts, RMDs are required from those accounts.

As an example, Sarah has a gap between the amount needed to cover monthly expenses and her Social Security income. She annuitizes 20% of her IRA to create additional predictable income to cover the gap. The 20% annuitized amount will not be included in any RMD calculations as it has been "distributed" from the account. The payments from the annuitized portion count as the RMD only for the 20% annuitized. Sarah will need to take RMDs from the remaining IRA assets. Note that the first year an annuitized payment is received is a bit tricky. As the annuitized payments are considered distributed, the annuitized income received in the FIRST YEAR ONLY can count toward any RMD.

Predictable income enough to cover essential expenses is often beneficial to retirees. While annuities offer many options for creating predictable income, this strategy can work for some retirees. These questions may help retirees with traditional IRAs determine if annuitizing a portion, or all, of the "spend down" account to create income suits their retirement needs.

Additional Resources and Links

Annuitizing an IRA and the Effect on RMDs

IRA Rollovers and Lifetime Income: A Game Plan

What Is Your Client's RMD Plan?

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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