INSIGHTS

PACIFIC LIFE

RETIREMENT STRATEGIES GROUP | FEBRUARY 2024 TAX PLANNING

Tax Deferral: A Valentine's Day Gift beyond Roses

For loved ones looking for ways to boost their retirement-savings plans, clients may want look outside the box for Valentine's Day gifts. Here's how you can guide clients to express their love in an unconventional way—through tax deferral.

Recently, a financial professional shared an outside-the-box—but quite meaningful—Valentine's Day gift that she encourages her clients to consider giving. Now understand, she also is a certified public accountant (CPA), so it isn't completely surprising that her idea of a Valentine's Day gift might be tax inspired. In this case, it can be a very effective strategy to help increase retirement savings.

She typically suggests this gift to dual-income professional couples who plan to retire in 10 to 15 years. These clients' current incomes place them in a high tax bracket at both the federal and state levels. That means they can reinvest only a portion of their investment earnings. It is frustrating for them, as they are trying to use their top-earning years to save more toward retirement. Even more frustrating, their taxes will change for the (much) better when they retire, as their incomes will be lower.

Saving Challenge during Peak Earning Years

Couples typically want to maximize their savings when they have the most discretionary income, that is, in their peak earning years. The challenge: That also is when they are likely to be in the highest tax bracket. This means less of every dollar earned from their investments will be reinvested.

In other words, clients are trying to maximize their retirement savings when they also are in higher tax brackets. What if those clients could defer paying taxes on their savings until they need the funds?

Tax Control through Deferral Can Help

Tax control means the owner of the tax-deferred account can (generally) control when taxes are due on gains by controlling the timing of distributions. (For a tax-deferred account, taxes are not due until a distribution is taken.) This is true for qualified accounts, such as traditional Individual Retirement Accounts (IRAs) and 401(k)s, required minimum distributions (RMDs) notwithstanding. It also is true for nonqualified tax-deferred annuities. A nonqualified annuity allows the owner to time the distributions with the associated taxes on gains, thus providing control.

What Makes a Nonqualified Annuity a Consideration for Savers?

For clients who want the ability to have more control over the timing of the recognition of gains, a nonqualified deferred annuity can mean:

- **More Gains Stay Invested.** As taxes are deferred until distribution, 100% of each reinvested dollar goes to work. The rule of 72 helps illustrate how deferral can help shorten the time needed for assets to reach a specific amount.
- **Potential for Tax-Managed Income.** A nonqualified annuity offers different ways to create cash flow. The client can choose to take a distribution, although this means gains are distributed first. The client also can elect partial or full annuitization and have exclusion-ratio tax treatment, which means each payment is a pro rata combination of return of premium and gain.

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- **Tax Control.** A nonqualified annuity allows the client to rebalance investment options and capture gains without immediately incurring taxes. This means more dollars stay invested for longer. It also means that the client has more control over the entries on Form 1099.

Remember—nothing worth having is free. Annuities have charges that vary depending on the type of annuity and investment options available. If the client is not age 59½ or older, there is an additional 10% federal income tax that may be applied to any distributed gains. But this strategy may work for a portion of the account.

So, what is the outside-the-box Valentine's Day gift this financial professional suggests clients consider for their loved ones? It's a nonqualified deferred annuity for a portion of their retirement savings. This financial professional focuses the investments on separate accounts that produce ordinary income—the same type of income the gains in the annuity produce. Every dollar of gain in the contract stays working until clients need the funds (or reach the age of contract maturity, which is age 100 in most states).

Valentine's Day is an opportunity to express love for those special people in our lives. What a caring way for dual-income couples to show their love for each other—a tool to help create a happy and comfortable retirement.

Reach out to your clients to share this unconventional but potentially rewarding Valentine's Day idea so they can communicate love through the gift of tax control.

ACTIONS YOU CAN TAKE RIGHT NOW

- **Connect with clients with loved ones who are saving for retirement.**
- **Discuss the potential benefits of tax deferral.**
- **Determine whether a nonqualified deferred annuity would be a helpful strategy for clients' loved ones.**

Additional Resources and Links

Seven Reasons to Gift a Roth Conversion for Valentine's Day

Nonqualified Annuities

The Power of Tax Deferral Tool

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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Annuity withdrawals and other distributions of taxable amounts, including death benefit payouts, will be subject to ordinary income tax. For nonqualified contracts, an additional 3.8% federal tax may apply on net investment income. If withdrawals and other distributions are taken prior to age 59½, an additional 10% federal income tax may apply. A withdrawal charge and a market value adjustment (MVA) also may apply. Withdrawals will reduce the contract value and the value of the death benefit, and also may reduce the value of any optional benefits.

Partial annuitization and withdrawals will reduce the contract value and the value of the death benefit, and also may reduce the value of any optional benefits. Partial annuitization is treated as a withdrawal and will reduce the contract value by the amount that is annuitized. Additionally, for contracts that hold an optional living or death benefit rider, partial annuitization may reduce the benefits guaranteed under the rider, depending on each rider's features and the amount that is annuitized.

Under current law, a nonqualified annuity that is owned by an individual is generally entitled to tax deferral. IRAs and qualified plans—such as 401(k)s and 403(b)s—are already tax deferred. Therefore, a deferred annuity should be used only to fund an IRA or qualified plan to benefit from the annuity's features other than tax deferral. These features include lifetime income, death benefit options, and the ability to transfer among investment options without sales or withdrawal charges.

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