Annuity Owners Receive Special Tax Advantages

Advanced Planning Solutions

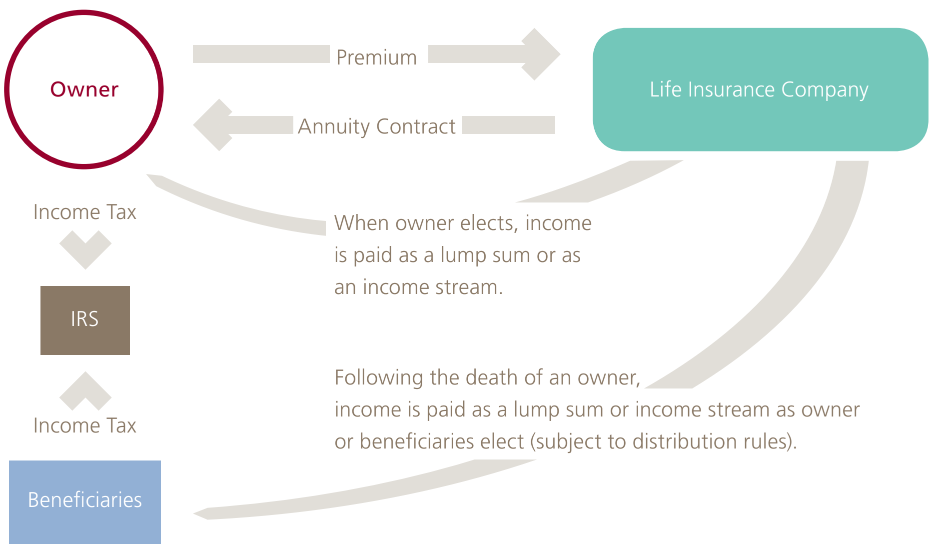
Summary

Annuities are retirement planning vehicles that are accorded special tax treatment under federal tax law. Learning the tax rules can help you take advantage of the benefits offered by annuities while avoiding any unintended tax results.

When accumulating in value, annuities are not subject to current income tax on the increase in value. When making distributions, the annuity income is taxed when it is received. Under some distribution options, a portion of each distribution may be excluded from income tax. Taxable income received before age 59½ also may be subject to a 10% additional tax.

If the owner of an annuity dies, the benefits may be paid to the beneficiary either in a lump sum or over time. A portion of these distributions will be taxable when received. Beneficiaries may be eligible for an income tax deduction for any estate taxes paid relating to the annuity.

How it works



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Tax considerations

- Premium payments for nonqualified annuities are not deductible. If an annuity is used as an investment vehicle for a qualified retirement plan or Individual Retirement Account (IRA), then the tax rules regarding the retirement arrangement apply, not the tax rules regarding annuities.
- Any increase in value of the annuity contract is not subject to tax until distributed. This is commonly known as tax-deferred growth.
- Most distributions are taxed to the extent that the annuity value exceeds the premium paid, as of the time of the distribution. This treatment applies to non-periodic distributions. Also known as "last-in first-out" tax treatment, distributions must be treated as taxable income first, then as return of premium.
- Different tax treatment applies if the income is considered "received as an annuity." This most often happens when a scheduled continuing stream that may not be altered has begun, whether it be for a period of years or over a lifetime. These distributions are treated as part taxable income and part nontaxable return of premium. The portions are determined by calculating an exclusion ratio that applies to all distributions. Any amount received after all premium is returned is fully taxable.
- Any distributions received before age 59½ are subject to income tax and a 10% additional tax on any taxable amount distributed. The 10% penalty does not apply to distributions made after the death of the owner, attributable to total disability, of equal periodic payments for life, or from an immediate annuity contract.
- Any loan, assignment, or pledge of the annuity will be treated as a distribution.
- No distributions are required to be made during the life of the owner until the maturity date stated in the annuity contract (usually the date the owner reaches age 80 or age 90).

  Distributions are required following the death of the owner. Usually, periodic distributions to the beneficiaries must begin within one year of the owner's death; alternatively, the entire value must be distributed within 5 years after the owner's death.

  If the owner dies after electing to take an income stream "received as an annuity," then the stream must continue to be distributed at least as rapidly as it was at the time of death.
- Because annuity taxation is intended to help individuals provide income for retirement, many of these annuity rules do not apply to annuity contracts owned by any entity that is not a natural person. For example, contracts owned by corporations or partnerships are not taxed as annuities. Annuities owned by trusts may receive annuity tax treatment if the trust acts as an agent for a natural person.
- This explanation is general in nature. Please consult product guides or prospectuses for more detailed product and tax information. This is not intended as tax advice. You are encouraged to consult a tax adviser regarding your specific situation.

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