Miller Wealth Advisors

CASE STUDY | VOLUME 111

PRIVATE LETTER RULING OPENS DOOR TO PLANNING OPPORTUNITY FOR BENEFICIARIES WHO INHERIT ANNUITIES

For inherited contracts with a significant amount of embedded gains, post-mortem strategy creates tax-advantaged wealth transfer and income plan for beneficiary.

THE SITUATION

Charlie Helms*, a retired musician living in Boynton Beach, recently died leaving three nonqualified annuities issued by different companies to his only daughter, Sara*, age 46. The annuities had a combined unrealized gain of $325,000 at Charlie's death. Sara and her husband Adam* are successful professionals who don't need any additional income and would rather defer the tax liability for as long as possible.

When a non-spousal beneficiary like Sara inherits a non-qualified deferred annuity, the common options for distribution are:

- 5-year window to deplete funds
- Life expectancy stretch on a LIFO basis
- Traditional annuitization using an exclusion ratio

THE PROBLEM

The chief drawback of non-qualified annuities is that they don't enjoy a step-up in basis at the owner's death. Instead, the income is classified as "income in respect of a decedent", treated as if the deceased person had lived to receive it, and subject to ordinary income.

PRIVATE LETTER RULING OFFERS SOLUTION

In Private Letter Ruling 201330016, the Internal Revenue Service allowed a beneficiary of three annuity contracts to transfer those contracts from the original issuing company into one contract with a different company via a 1035 exchange.

In this ruling, the IRS acknowledged that the beneficiary of the inherited annuity is really "the new owner of the original contract", therefore satisfying the technical requirements for a post-mortem 1035 exchange.

THE SOLUTION

While the Private Letter Ruling is only binding for the taxpayer requesting it, the insight led us to propose to Sara that she exchange all three of her father's annuity contracts into a single contract with better features, investment options and tax-efficiencies.

THE OUTCOME

The newly selected contract will provide Sara:

- A guaranteed income stream that stretches over her life expectancy,
- Tax-efficient income that applies the exclusion ratio to each payment,
- Better control of investment options, and
- Full access to her contract value.

Most importantly, the result addresses Sara's desire to minimize taxes from the inherited annuities.

*Client names have been changed to protect confidentiality. | This is a hypothetical example for illustrative purposes only. The experience of this client may not be representative of the experience of all clients and is not indicative of future results. Any tax advice contained herein is of a general nature and is not intended for public dissemination. Further, you should seek specific tax advice from your tax professional before pursuing any idea contemplated herein. | Variable Insurance products are sold by prospectus. For more information about the product, including its features, charges, and expenses, please read the prospectus. Please consider the charges, risks, expenses, and investment objectives carefully before investing. The prospectus is available from your financial professional. Securities offered through Valmark Securities, Inc., Member FINRA, SIPC. Investment Advisory Services offered through Valmark Advisers, Inc., a SEC Registered Investment Advisor | 130 Springside Drive, Akron, OH 44333. 800.765.5201. | Miller Wealth Advisors, LLC is a separate entity from Valmark Securities, Inc. and Valmark Advisers, Inc.

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