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Stretched Out?

Consider SPIA-to-Life Strategy for Qualified Wealth Transfers

Does 'Pay to Delay' Still Hold Sway?

The elimination of the Stretch IRA for many clients (now replaced by a 10-year payout window for most beneficiaries) calls traditional strategies into question.

Help your clients weigh the pros and cons. How much sense does it make to delay distributions from IRAs and qualified plans for as long as possible? Doing so may eventually produce higher overall required minimum distributions (RMDs) that in turn not only push clients into higher tax brackets but ultimately also leave their beneficiaries shouldering heavier tax burdens.

Given those potential pitfalls, tax-free legacy options – ones such as life insurance and Roth conversions – merit consideration. Drawing on IRAs and qualified plans during lifetime to fund life insurance for wealth transfer can be an effective strategy. Consider, for example, the following case study.

Olivia Looks to Optimize a Legacy IRA

Olivia, age 70, has $1 million in a traditional IRA. As she believes herself to be comfortably situated with other assets and income sources, she doesn't foresee needing the IRA funds. Her daughters are her beneficiaries.

She buys a qualified single premium immediate annuity with $840,000 from her IRA.[*] It will pay her $53,000 annually for the rest of her life.[1] Assuming a 22% income tax rate (combined federal and state), the net payment will be $41,340. Olivia could buy the SPIA with all of her "surplus" IRA funds, but she feels more comfortable leaving aside a portion just in case an unforeseen need should arise.

Olivia is insurable as a standard, non-tobacco user. She purchases a guaranteed universal life (GUL) policy. She commits to paying a $41,251 annual premium for the rest of her life. Like the SPIA, the GUL policy also provides a considerable measure of certainty. It is guaranteed as long as the premiums are paid on time. Her premium purchases a $1.2 million death benefit.[2]

Olivia could choose to pay the annual premium by simply taking the necessary withdrawal from her IRA each year, i.e., without purchasing the SPIA. However, there is no guarantee that the IRA will not suffer any losses. There could certainly be down markets when taking a withdrawal would not be recommended. Sequence of returns risk is a very real consideration once withdrawals begin.

*Assuming adequate resources to address emergency and current living expenses.

Olivia's Outcomes: Considering Performance Possibilities

How might Olivia's purchase of the qualified SPIA and GUL policy compare to simply allowing the traditional IRA to go on growing as is?

In this scenario, the $1 million traditional IRA and the $160,000 IRA both are assumed to grow at 4% annually, with a 43% combined federal and state rate for taxes paid in the year of death. Taking of RMDs is assumed to begin at age 72, with after-tax amounts reinvested in a taxable account with a 1.56% after-tax return.

Proceeds to Beneficiaries: 20-Year Perspective

	Option 1	Option 2		
Year	**IRA Only***	**IRA***	**Life Insurance Death Benefit**	**Total**
1	$570,000	$91,200	$1,200,000	$1,291,200
5	$692,046	$109,083	$1,200,000	$1,309,083
10	$874,081	$134,394	$1,200,000	$1,334,394
15	$1,073,805	$161,578	$1,200,000	$1,361,578
20	$1,279,861	$190,785	$1,200,000	$1,390,785

*Assumes 4% growth for IRA (net of RMDs) plus growth of RMDs remaining after taxes at after-tax rate of 1.56%. For example only. Actual results will vary.

This hypothetical scenario shows an immediate benefit with Option #2 – the SPIA/GUL strategy – should Olivia die in the first year … or for the next 19 thereafter. That advantage comes from the guaranteed death benefit. Option #1 could potentially surpass Option #2, should Olivia survive more than 20 years.

When determining whether to pursue life insurance or Roth conversions, insurability is the first consideration. Provided both options are viable, life insurance will generally favor those who do not live as long. Alternatively, Roth conversions will generally favor those who live longer and enjoy more time for Roth IRAs to grow tax-free. Clients can potentially even hedge their approach by employing both strategies.

Ready to discuss changed rules and respond with new strategies?

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1 Life with 10-year period certain payout for female age 70; hypothetical example for illustration only; quoted 3/23/20. Single Premium Immediate Annuity contract series ICC16 ENT-01 1701, ENT-01 1701 NY, Deceased Commutation Rider series ICC09 ER.02 0901 and Living Commutation Rider series ICC09 ER.01 0901. Integrity Life Insurance Company, Cincinnati, OH, operates in DC and all states except NY, where National Integrity Life Insurance Company, Greenwich, NY, operates. W&S Financial Group Distributors, Inc. is an affiliated agency of the issuer. Issuer has sole financial responsibility for its products. All companies are members of Western & Southern Financial Group. Payment of benefits under the annuity contract is the obligation of, and is guaranteed by Integrity Life or National Integrity Life. Guarantees are based on the claims-paying ability of the company issuing the annuity. Products are backed by the full financial strength of the issuing company. Earnings and pre-tax payments are subject to income tax at withdrawal. Withdrawals may be subject to charges. Withdrawals of taxable amounts from an annuity are subject to ordinary income tax, and, if taken before age 59½, may be subject to a 10% IRS penalty. Interest rates are declared by the insurance company at annual effective rates, taking into account daily compounding of interest. Product and feature availability, as well as benefit provisions, vary by state.

2 Hypothetical example for illustration only; for female, age 70, non-tobacco status, death benefit option 1; subject to underwriting approval; quoted 3/23/20. Issued and sold by Columbus Life Insurance Company, Cincinnati, OH. Columbus Life operates in DC and all states except NY. Payment of benefits is sole financial responsibility, and backed by full financial strength, of issuer. Flexible Premium Universal Life Insurance Policy series ICC10 CL 87 1006, Accelerated Death Benefit Riders CLR-137 1208, CLR-143 1208, CLR-179 1208, and CLR-202 1409. Product and rider provisions, availability, definitions and benefits may vary by state. Not distributed by W&S Financial Group Distributors.

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