# Are you leaving behind a tax burden?

## IRA Strategies

Policies issued by American General Life Insurance Company (AGL), Houston, TX, and The United States Life Insurance Company in the City of New York (US Life), members of American International Group, Inc. (AIG).

# The dilemma

Many people who have been successful in saving for retirement have established a large enough nest egg to be able to create a legacy for their children, grandchildren and favorite charities; leaving them to wonder how to best leverage their qualified or tax-advantaged retirement plans. A common concern is whether financially successful retirees should make their children the beneficiaries of their IRA, leaving a likely income tax burden.

**Over the next 25 years, an estimated $68 trillion will change hands from aging households to their heirs and charity.**[2]

# Tax saving alternatives using life insurance

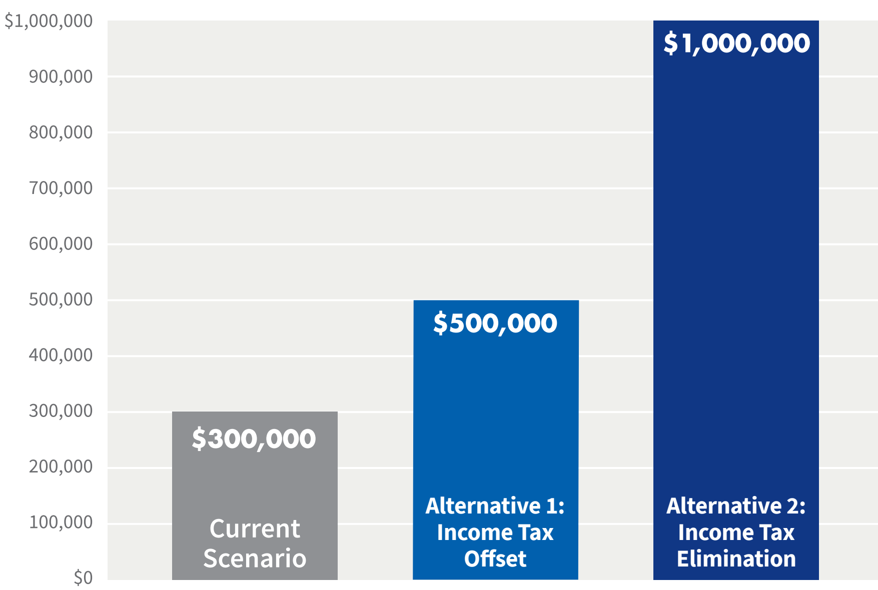
If an IRA owner is looking to protect loved ones and to help maximize wealth transfer, he/she can utilize life insurance to help minimize the tax burden that inheriting an IRA may impose on a beneficiary. With two different strategies identified in this brochure, individuals can help **maximize the after-tax** value of their inheritance or even **eliminate taxes paid** on the IRA inheritance.[1]

The chart below provides a hypothetical comparison of what IRA distributions look like on the same IRA account before (“Current” bar) and after (“Tax Offset” and “Tax Elimination” bars) the two solutions were used. These strategies can help offset or eliminate the tax burden on the beneficiaries, maximize the amount of money beneficiaries receive and provide greater flexibility in how the assets are ultimately put to use.

# After-tax benefit amounts

## Comparison of wealth transfer alternatives for a $500K IRA

This chart illustrates the potential benefits of the two alternatives discussed on the following pages, compared to doing nothing. Policy owners should undertake planning with the assistance of legal, financial or tax advisors.




Fees and charges, if applicable, are not reflected in this example and would reduce the IRA amounts shown.
This chart does not take into account any costs associated with the purchase of the life insurance policy on the net wealth of the policy owner(s).

# What will an IRA be worth when transferred?

If you plan to pass an unneeded IRA to a beneficiary, proper consideration should be given to IRA required minimum distributions and the resulting effect these can have on the amount a beneficiary may inherit upon IRA owner's death.

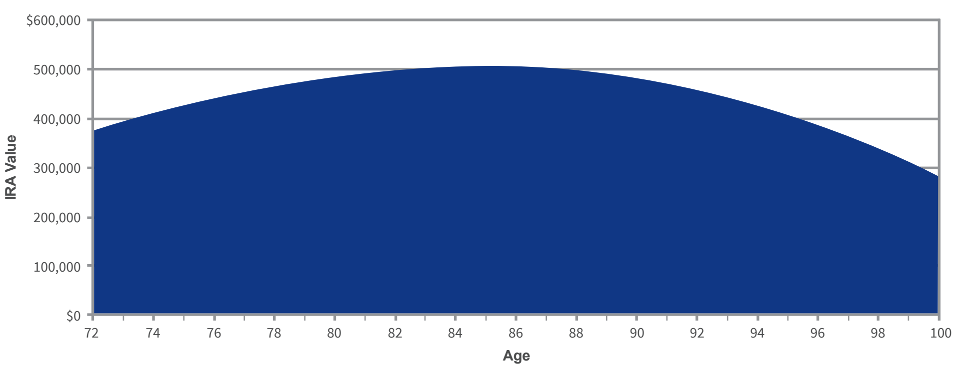
- Beginning at age 72, the IRA owner is required to withdraw an increasing percentage of an IRA's account value each year until the IRA is exhausted – "Required Minimum Distribution (RMD)."
- Eventually RMDs will be larger than the expected annual interest growth. When that happens, the IRA may well be at its peak value, typically between ages 85 and 90, as depicted in the chart below.[3]
- When an IRA owner dies, the beneficiary must include taxable amounts received in his or her gross income.
- Because IRAs are frequently transferred at or near their peak value, the higher values can cause an increase taxable income for the beneficiaries.

It is not uncommon for retirees to die sometime between their 75th and 95th birthday. As the graph below depicts, when that happens IRAs are often passed to the next generation at-or-near peak values. Because these IRA inheritances are fully taxable to the beneficiaries as ordinary income, they may be taxed at very high rates.

# Hypothetical IRA peak value estimation

## Due to annual growth and Required Minimum Distributions

Let's take a look at a hypothetical example of an IRA valued at $380,000 at age 72. With an estimated annual growth of 7% and Required Minimum Distributions* taken out every year, you can see the estimated curve in the values over time. At age 80, the estimated value is approximately $500,000.




**Hypthetical IRA assumes $380,000 IRA with a 7% hypothetical return.**

Fees and charges, if applicable, are not reflected in this example and would reduce the amount shown. Income taxes on tax-deferred accounts are payable upon withdrawal, including RMDs. This hypothetical example does not reflect the return of any specific investment and is not a guaranteed of future value or results

* The rules governing RMDs are complex and subject to modification. Individuals should seek the advice of an independent tax advisor or attorney for more complete information concerning their particular circumstances.

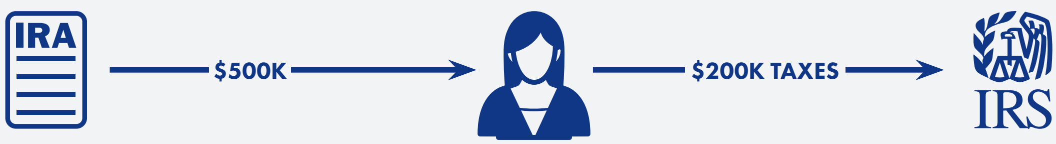
# Innovative alternatives for IRA transfer

The two solutions described here may help reduce or eliminate the taxes imposed on an IRA beneficiary, thus helping maximize the value of the inheritance.

**"Current" Scenario** It is not uncommon for an IRA owner to use other portfolio assets for retirement and living expenses, passing on the majority of the IRA balance (along with the tax liability), to the beneficiary at the owner's death.[4]

- At IRA owner's death, the IRA balance is paid to the beneficiary
- Income taxes are due on the IRA amounts received by the beneficiary[5]
- If a beneficiary is in his/her 50's and 60's at IRA owner's death, potentially earning his/her highest career income, he/she may pay taxes in a high income tax rate. The addition of IRA inheritance to beneficiary's existing taxable income could push the recipient into a higher tax bracket.
- This can result in excessive income taxes to the beneficiary, reducing the net value of his or her inheritance — see diagram below for an example.
- The constraints of maintaining the asset's tax deferred status may not meet the beneficiary's existing financial and retirement planning needs.

# Estimating tax impact of IRA inheritance

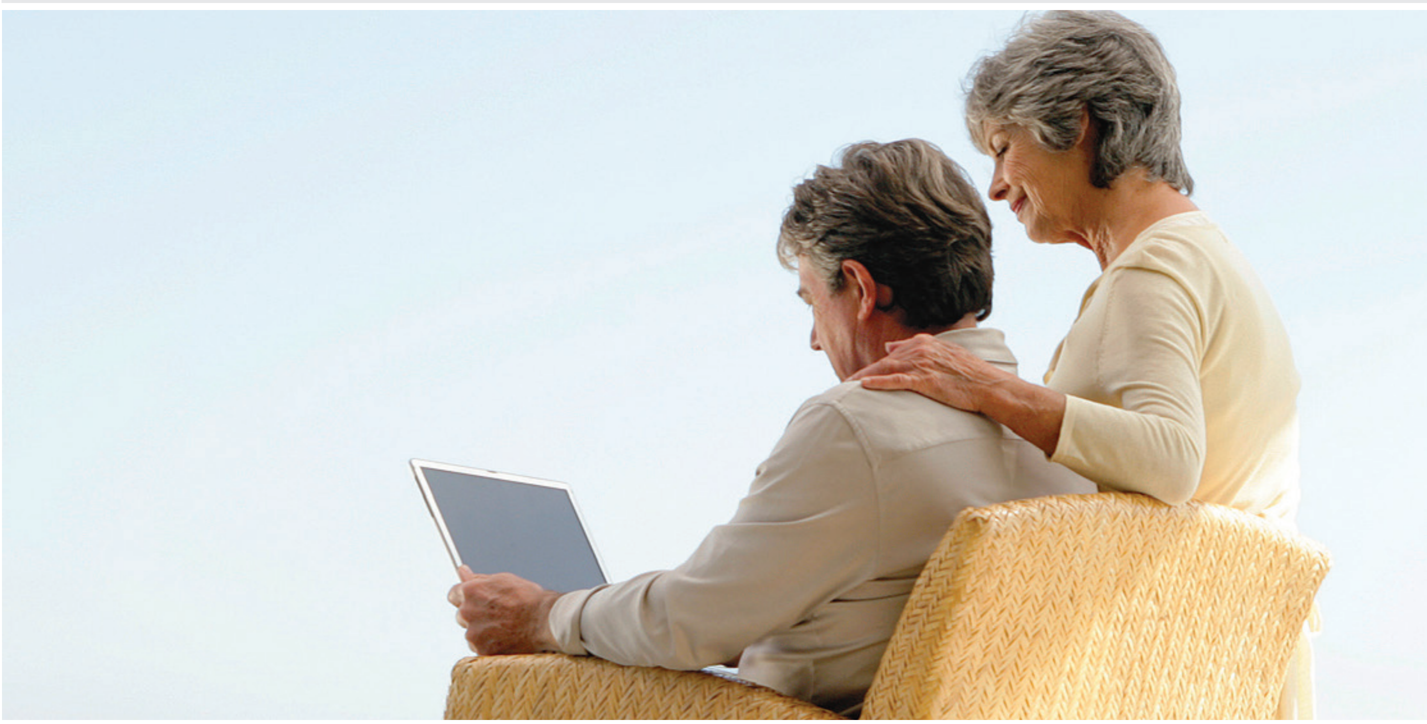



Determine hypothetical value of IRA when it would be transferred to beneficiary

Estimate income tax rate for beneficiary, including the lump sum IRA inheritance

Calculate the estimated income taxes owed to the IRS.

| | | |
|---|---|---|
| **Estimated value at age 80 ....................** | **x Estimated income tax rate ...........** | **= Taxes owed by beneficiary** |
| **$500,000 ...........................................** | **x 40%...........................................** | **= $200,000 tax burden; $300,000 net inheritance.** |



# **Solution 1:** Offset IRA beneficiary income taxes

Options include the purchase of a life insurance policy equal to the anticipated income tax due from beneficiary at projected time of inheritance. Life insurance benefit may be used to pay the income tax due, maintaining the full value of the IRA.

### IRA Income Tax Offset Solution

IRA | Life Insurance Policy

**$700K Combined Value**

Purchase life insurance to cover beneficiary's tax burden

Beneficiary receives IRA and insurance benefits

**$200K TAXES**

IRS

Life insurance proceeds used to pay tax bill

| | | |
|---|---|---|
| **Estimated value at age 80** | **x Estimated income tax rate** | **= Taxes owed by beneficiary** |
| **$500,000** | **x 40%** | **= $200,000 tax burden; $500,000 net inheritance.** |

**RESULTS:** Beneficiary receives life insurance death benefits , generally, **income tax-free** and can use those funds to pay the taxes due on IRA inheritance.[6]

- The beneficiary receives $500,000 ($300,000 net of taxes from IRA and $200,000 from life insurance death benefits). Beneficiary then has discretion to invest/use full value associated with the IRA funds.

# **Solution 2:** Eliminate IRA beneficiary income taxes

By creatively incorporating a charity and funding a life insurance policy for beneficiaries, the federal taxes on the distribution of an IRA can be completely eliminated.

### Part 1

Name a tax-exempt charity as the IRA beneficiary. With the charity's tax exempt status, no taxes will be due on the inherited IRA funds.

See example at right:

### IRA Income Tax Elimination: Charitable Bequest

IRA

**$500K**

Name tax-exempt charity as beneficiary of IRA.

Charity receives IRA at death; no income taxes are paid on IRA proceeds

| | |
|---|---|
| **Estimated value at age 80** | **Charitable beneficiary is tax exempt** |
| **$500,000** | **$500,000 IRA proceeds tax-free** |

### Part 2

To prevent disinheriting the beneficiary, purchase a life insurance policy equal to the estimated peak value of the IRA. The beneficiary would receive the life insurance death benefit income tax-free under the current tax law .[6]

See example at right:

### IRA Income Tax Elimination: Combined Legacy

Life Insurance Policy

**$500K**

Purchase life insurance policy for full estimated IRA value, $500,000

Beneficiary receives $500,000 income tax free

| | |
|---|---|
| **Life insurance benefit** | **Benefits received at death** |
| **$500,000** | **$500,000 income tax-free proceeds** |

**RESULTS:** Total wealth transferred ($1,000,000) is more than three times the amount of net after-tax IRA inheritance in the current scenario ($300,000), and the income taxes have been eliminated.

- Beneficiary of life insurance policy receives full $500,000 death benefit (equal to estimated IRA value), generally, income tax-free.[6]
- Charitable IRA beneficiary receives full $500,000 value of IRA income tax-free (at IRA owner's death)
- Zero Federal income taxes are paid on either the IRA or the life insurance policy

It is important to note that life insurance policies differ and are subject to premiums and fees. Please speak to an appropriately licensed insurance agent for more information.

[1] American General Life Insurance Company and their distributors and representatives may not give tax, accounting or legal advice. Any tax statements in this material are not intended to suggest the avoidance of U.S. federal, state or local tax penalties. Such discussions generally are based upon the company's understanding of current tax rules and interpretations. Tax laws are subject to legislative modification, and while many such modifications will have only a prospective application, it is important to recognize that a change could have retroactive effect as well. Individuals should seek the advice of an independent tax advisor or attorney for more complete information concerning their particular circumstances and any tax statements made in this material.

[2] Cerulli Associates, U.S. High-Net-Worth and Ultra-High-Net-Worth Markets 2018: Shifting Demographics of Private Wealth. 2018.

[3] Depends on life expectancy factors, the assumed annual rate of return and additional deposits or withdrawals made.

[4] The type of the beneficiary and the tax laws at the time of inheritance may allow for deferral of taxation until the time of distribution of the funds from the inherited IRA.

[5] Under the SECURE Act, "Designated Beneficiaries" may defer taxes on their inherited IRA for up to 10 years. Some beneficiaries will be subject to different distribution requirements. Additionally, a surviving spouse beneficiary may transfer the IRA into his/her own name and delay distribution until age 72, for spouses born after June 30, 1949.
However, the taxable portion of the IRA at date of death will ultimately be subject to federal income. For advice concerning your individual circumstances, consult your attorney, tax advisor, or accountant.

[6] Life Insurance death benefits are generally tax-free for beneficiaries under IRC101(a), but may be taxable in part or whole under certain situations. For advice concerning your individual circumstances, consult your attorney, tax advisor, or accountant.

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**For more information, contact your financial professional.**

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Please speak to an appropriately licensed insurance agent for more information.

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