Accessing Non-Qualified Annuity Values

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Reports suggest that more than 2 trillion dollars is invested in non-qualified annuities in the United States. Many of those plans have a low cost basis/significant gain and represent a tax challenge when the owner wants to access the funds. For some, the previously purchased annuity now represents a pool of money earmarked for long term care (LTC) expenses. For others, the annuity was originally purchased to provide additional retirement income for which the client no longer has a need.

Money coming out of a non-qualified annuity will be taxed (LIFO) as ordinary income, even if the funds will be used to pay LTC expenses. One strategy for your clients to consider in this situation is using an annuity plan with an LTC rider. By exchanging (1035) an annuity for a plan with an LTC rider, withdrawals for qualifying long term care expenses are not subject to income tax (tax advantages from the Pension Protection Act) and the pool of money created may be 2 or 3 times the account value.

Different than most deferred annuity plans, those with LTC riders generally require underwriting. Though many carriers do have relaxed underwriting for these plans, which may sound attractive, more underwriting or more stringent underwriting usually translates to more attractive benefits and pricing. In addition, the cost for the LTC rider will impact the return as there is considerable expense associated with the LTC protection.

Clients with annuity plans that have an LTC rider have the option to access their accumulated values (and possibly much more) as an LTC benefit when they qualify. Accessing funds as an LTC benefit provides tax favored access to a potentially larger pool of money. Should your client pass away and never need the LTC benefit, the account value will pass to their named beneficiaries with tax consequences no different than their old, deferred annuity.

Qualifying for LTC benefits is similar to most mainstream LTC plans in that those who cannot perform 2 of 6 activities of daily living or have a significant cognitive impairment will qualify. The annuity options remain similar to deferred annuity plans without an LTC rider.

While many financial advisors don't regularly recommend non-qualified annuities, many of their clients own them (possibly purchased through a prior advisor). Too often, the annuity finds its way to the back burner while investment advisors focus on investable assets and don't want to do anything that might trigger ugly taxation. Utilizing an annuity plan with an LTC rider may provide an attractive way to reposition the asset and address long term care concerns.