



# Advanced Income Solutions

## New York Life (NYL) Deferred Annuities and Taxation

Non-qualified Deferred annuities offer favorable tax treatment since you are not required to pay taxes on gains until you withdraw them from the policy. This means earnings within the annuity contract can grow on a tax deferred basis until withdrawn, ideally when in a lower tax bracket.<sup>1</sup>

The owner of the annuity is responsible for paying the taxes on any gains distributed from the annuity while living. If there are multiple owners, NYL will issue tax reporting on the primary owner. The client should consult with their tax advisor on the implications of naming multiple owners.

The beneficiary is responsible for the taxes on any gains in excess of basis when they inherit the annuity death benefit proceeds. There is no “step-up in basis” applicable to annuities.

All taxable distributions will be taxed as ordinary income and do not qualify for reduced tax rates that apply to long-term capital gains and dividends. If the owner and beneficiary are a trust which has its own tax ID number, and therefore a separate entity, taxes are at the trust’s tax rate. Below are some events and annuity taxation rules to keep in mind with respect to NYL annuities.

<sup>1</sup> *If the funds invested in the NYL annuity are tax-qualified (pre-tax dollars) there is no additional tax benefit since tax-qualified plans already provide tax deferral. Additionally, the entire distribution will be subject to taxes upon withdrawal or death of the owner.*

### Distributions from NYL Annuities

There are several ways to receive distributions from a NYL annuity. Most of the NYL deferred annuities allow for a certain percentage that can be withdrawn free of insurance company surrender charges. However, if withdrawals are taken from the annuity prior to reaching age 59½ there is a 10% federal tax penalty, unless the owner of the annuity qualifies for one of the exceptions to the penalty tax. There is never a penalty tax if distributions are taken due to the owner’s death.

*NYL does not code distributions according to most of the IRS exceptions since we do not verify individual client circumstances. Clients will need to work with their tax professional to reconcile any tax reporting if they believe they qualify for an exception.*

**Partial withdrawals**—Withdrawals from a non-qualified annuity are distributed on a last-in-first-out basis

(LIFO). This means that gains come out first, then basis (investment). This also applies to partial withdrawals taken under our waiver of surrender charge provisions.

*For policies issued pre-August 14, 1982, withdrawals are distributed on a first-in-first-out basis (FIFO). These policies are grandfathered even if 1035 exchanged.*

**Full surrender**—Upon surrender of a non-qualified annuity the entire accumulation value is paid out and all accumulated gains are subject to ordinary income taxes.

*If the annuity owner receives a lump sum distribution that is less than the investment or basis in the contract, they may be able to claim the loss on their federal tax return. Surrender charges assessed will not qualify as a loss. The client should discuss this issue with a tax professional.*

Continued on the next page.

Investments and insurance products are:  
Not FDIC/NCUA Insured • Not Insured by Any Federal Government Agency • Not a Deposit  
or Other Obligation of, or Guaranteed by, the Bank or Any of Its Affiliates • May Lose Value



**Annuitization**—When a contract is annuitized withdrawals can be paid out over life expectancy, no matter how long you live. However, there are also non-life contingent annuitization options (such as payout only over 10 years). With an annuitization the tax liability is spread out, with some interest earnings included in the income payment (based on an exclusion ratio) and subject to taxes in the year received.

*Request from your financial services professional a variable annuity product and funds prospectuses. Investors are asked to read the prospectuses carefully and consider the investment objectives, risks, charges, limitations, and expenses of the investment before investing. Please read*

the prospectuses carefully before investing. This material is general in nature and is being provided for informational purposes only. It was not prepared, and is not intended, to address the needs, circumstances and/or objectives of any specific individual or group of individuals. Withdrawals and distributions of taxable amounts are subject to ordinary income taxes and if made prior to age 59½ may be subject to an additional 10% federal income tax penalty. Products and features are available where approved. In most jurisdictions, the policy and rider form numbers are as follows, state variations may apply: New York Life Premier Variable Annuity–FP Series ICC19V-P06 or it may be IC18V-P06.

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## Distributions from Policies with Living Benefit Riders

Many variable, fixed and index annuities offer optional income riders. The tax treatment for distributions from non-qualified policies under the terms of these riders may differ.

### **Guaranteed Lifetime Withdrawal Benefit (GLWB)**—

GLWB withdrawals are guaranteed for life. These withdrawals are distributed on a LIFO basis and once all basis is recovered withdrawals are 100% taxable. There is no exclusion ratio applicable to GLWB withdrawals.

### **Guaranteed Minimum Accumulation Benefit (GMAB)**—

There is a waiting period before this benefit is effective. Once the GMAB waiting period has been met and the rider is exercised, if additional amounts are added to the policy to increase the contract value to equal the guaranteed amount, when distributed any amount in excess of the basis would be considered gain and subject to taxes.

### **Guaranteed Minimum Income Benefit (GMIB)**—

This type of rider generally requires a waiting period to exercise (e.g., 10 years) and essentially guarantees a minimum amount that can be annuitized. Since this is an annuitization benefit there is an exclusion ratio applied to the income stream so the tax liability is spread out, with some interest earnings included in the income payment (based on an exclusion ratio) and subject to taxes in the year received.

*The NYL Premier FP variable annuity offers the optional Investment Preservation Rider which is known as a GMAB. The New York Life Clear Income Advantage Fixed Annuity–FP Series includes a GLWB rider. NYL currently does not market an annuity with a GMIB rider.*

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## Common Annuity Distributions that allow for Exceptions to the 10% Tax Penalty

Since deferred annuities are considered long term savings vehicles, the IRS imposes a 10% penalty tax on any withdrawals of gain when the owner is under 59½. If the funds are qualified the premature tax penalty is on the entire distribution. There are a number of exceptions to the application of the penalty tax. A payment that is part of a series of Substantially Equal Periodic Payments (SEPP) made for the life or joint life expectancy of the owner and their designated beneficiary qualifies for an exception. The SEPP exception applies to both qualified annuities (under 72(t)) and non-qualified annuities (under 72(q)).

**72(t)**—This rule allows you to take substantially equal periodic payments (SEPPs) from your IRA annuity or Tax Sheltered Annuity (based on one of three IRS approved methods) free of the IRS 10% penalty tax. You can decide to start taking 72(t) payments at any age however, payments must continue for at least five years or until you are age 59½, whichever period is longer. SEPPs from a Tax Sheltered Annuity cannot commence until the employee has separated from service. Amounts distributed are subject to ordinary income taxes.

**72(q)**—This rule allows you take substantially equal periodic payments (SEPPs) from a non-qualified annuity (based on one of three IRS approved methods) free of the IRS 10% penalty tax. You can decide to start taking 72(q) payments at any age however, payments must continue for at least five years or until you are age 59 ½, whichever period is longer. Amounts distributed would be on a LIFO basis and subject to ordinary income taxes.

*These distributions can be calculated using the Systematic Withdrawal Calculator in NYLIS. Alternatively, the client can obtain this calculation from their tax professional. The client should consult their own tax professional before pursuing these withdrawals as we cannot give individual tax advice.*

*Payments distributed from the New York Life Guaranteed Lifetime Income Annuity II and Guaranteed Future Income Annuity II meet the Substantially Equal Periodic Payment rule and are not subject to the premature distribution penalty tax. **NOTE:** only life contingent income annuities meet the SEPP exception. Fixed period annuities with no life contingency may meet the “immediate annuity” exception but that exception only applies to NQ annuities.*

Below are some unique tax rules to keep in mind during the annuity accumulation phase.

## Annuity Taxation and Accumulation Value

**Partial 1035 exchange and 180-day rule**—If an owner does a partial 1035 exchange from one annuity to another, there is a 180 day (6 months) waiting period following the partial exchange. If a withdrawal or surrender is subsequently taken from either contract involved in the exchange during this period following the exchange, the IRS may invalidate the tax-free nature of the exchange. The exception to this rule would be if the new contract is an immediate income annuity with at least a 10-year period certain or lifetime contingency. The existing policy however will remain under the 180-day waiting period for withdrawals.

**Aggregation rule**—All non-qualified deferred annuity contracts purchased by the same policyholder, from the same insurer (or an affiliate), during the same calendar year, must be aggregated and treated as one contract when calculating the taxable amount of a partial withdrawal or surrender from any of the annuities that are subject to aggregation.

**Ownership change/Gift of an Annuity**—The owner of a non-qualified annuity may transfer annuity ownership to someone else but there may be immediate tax implications in doing so. When annuity ownership is transferred to someone else this may trigger a taxable event for the donor. You may have to pay income taxes on any gains at the time of the transfer, additionally you may be liable for gift taxes. This is generally not the case if ownership is transferred between spouses or to one's Grantor trust.

**Collateral assignment**—The owner of a non-qualified annuity may collaterally assign the value of their NYL annuity. Typically, this would be done to secure a loan or as security for repayment of an obligation. A collateral assignment of a non-qualified annuity is considered a taxable event to the owner of the contract in the year of the transaction.

NYL administers to the Federal tax law's non-qualified annuity aggregation rule. NYL does not tax report on the other transactions discussed immediately above. Additionally, NYL will only permit collateral assignments for non-qualified annuities. The client should consult with their own tax professional before pursuing any of these transactions.

Below are some tax rules you may come across pertaining to annuity distributions upon death, which may be beneficial to know.

## Annuity Taxation and Distributions Upon Death

**Estate tax**—The value of the annuity at the time of the owner's death is generally included in the deceased owner's estate, for estate tax purposes. Whether one's estate is subject to estate tax depends on the value of the entire estate. Assets transferred to spouses are exempt from estate tax.

**Inheritance tax**—Some states enforce an inheritance tax on those that receive assets from the estate of a deceased person. However, inheritance taxes mainly affect more distant family members or unrelated heirs. The inheritance tax is levied on the value of the inheritance received by the beneficiary, and it is the beneficiary who pays it.

**Income in Respect of a Decedent**—When the owner dies the income tax liability is passed on to the beneficiary of the annuity. This income which is accrued before the owner's death that is now taxed to the beneficiary is called Income in Respect of a Decedent (IRD). Since the asset producing the IRD is also included in the decedent's estate, the beneficiary may be entitled to a deduction for the estate tax attributable to the IRD in order to minimize potential double taxation.

**Fair Market Value (FMV)**—This is the accurate assessment of the value of the assets as of the applicable valuation date. The FMV is used for estate tax purposes. The IRS also requires IRA trustees and issuers to report to IRA owners and the IRS by January 31<sup>st</sup> of each year the fair market value of the IRA as of the end of the prior year.

In addition to the Federal income, gift and estate tax rules that apply to annuities, there are state tax rules which vary by State. The state tax treatment of annuities is not discussed here. NYL does not give tax or legal advice. The client will need to consult with their own tax and legal advisors for more information on these rules and whether it applies to their individual circumstances.

Deferred annuities offer the opportunity to set aside assets for savings and retirement on a tax deferred basis. They also provide the option to convert the annuity value to a stream of guaranteed income to help assure you do not outlive retirement income. Along with these benefits are a set of tax rules that are important to understand to help ensure there are no unforeseen or unwanted tax implications. This information is intended to help by providing a brief overview of some of the tax rules applicable to annuities.

Federal tax laws are complex and subject to change. The information in this document is based on our interpretation of current tax laws. New York Life cannot give tax advice, clients should consult with their personal tax professional about their specific circumstances.

Neither New York Life Insurance Company, nor its agents, provides tax, legal or accounting advice. Please consult you own tax, legal or accounting professional before making any decision. Advanced Income Solutions (AIS) is a New York Life team that provides guidance on advanced annuity planning, any communication provided by the Advanced Income Solutions (AIS) team is intended primarily for internal adviser use and for informational purposes only. AIS does not attempt to address all financial issues that may impact a given situation, and provides information based on a general understanding of relevant facts, applicable rules product features and financial principles, as well as certain assumptions based on information provided regarding the adviser's clients specific situation. There can be no assurances that any product solution suggested by AIS will be successful. Actual results will vary based upon the individual situation and the actual performance of any products or investments ultimately purchased. Moreover, the information offered by AIS does not constitute specific investment or individual tax or legal advice. Individuals should therefore be advised to consult with their legal or tax professional, if applicable, regarding their specific situation before implementing any solution suggested by AIS.