

Cultivating Financial Independence in Honor of Fourth of July

Are clients considering all their options for financial independence in retirement? Here's how new regulations have made partial annuitization of qualified accounts a strategic option.

Independence Day, commonly known as the Fourth of July, is a celebration of the liberation and self-sufficiency of the United States. Whether it's observed with parades and fireworks or family gatherings, it's fundamentally about honoring the freedom that comes with self-determinism. The same also applies with financial independence in retirement: The ability to financially sustain oneself is a vital step in being free to pursue personal goals without the need to work for income. So, how can you encourage clients to engage in discussions about achieving financial independence in retirement? First, it helps to make these conversations about what clients can look forward to.

During the "Go-Go" years of retirement—which are the early years when retirees are more active—encourage clients to relish the freedom to use their time however they want. They'll want to have funds for travel, hobbies, or priceless experiences with loved ones. Then, as they transition into the "Slow-Go" years, clients will want to prioritize distribution planning for essential expenses and efficient tax strategies to help with income later in life. For example, with many qualified plans and IRAs, it's common knowledge that taxes are due on retirement savings once individuals reach age 73—the current age when required minimum distributions (RMDs) must start. Which strategies can assist clients in reducing income taxes without sacrificing the income they need during both phases of retirement?

In the Setting Every Community Up for Retirement Enhancement (SECURE) Act 2.0, the introduction of Section 204 made annuitization an appealing choice for

many clients. In a nutshell, payments from annuitized contracts for qualified or IRA accounts now count toward clients' total RMDs for the year. This provides clients with the opportunity to simultaneously plan their incomes, explore flexible investment options, and engage in legacy planning. Let's explore an example of how this strategy could work.

Qualified Longevity Annuity Contract (QLAC)

QLACs were not a product of the SECURE Act 2.0, but they may provide a complementary strategy to lower client RMDs. According to SECURE Act 2.0, a client is allowed to carve out a lifetime amount of up to \$200,000 to purchase a deferred income annuity (DIA). How does this help?

- Meet River, a client whose latest year-end IRA value was \$1 million and who turned 73 this year.
 - River's RMD for this year would be \$40,485.83 using the Uniform Life Expectancy table factor of 24.7 for a 73-year-old.
- River uses \$200,000 of IRA assets to purchase a QLAC with payments beginning at age 85 (the furthest a client can defer payments under a QLAC) before she turns 73.
 - Her RMD for this year will be based on the remaining \$800,000 and will therefore be reduced to \$32,388.66.

That is nearly an \$8,000 reduction in total RMDs. At first glance, it may not seem significant, but let's dive deeper into how the SECURE Act 2.0 has bolstered this strategy.

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Annuitization

Prior to 2023, annuity payments could not be used in aggregate with a client's total annual RMD. If he or she initiated a stream of payments through an annuity, it was presumed that those payments fulfilled the RMD obligation for that specific contract, irrespective of the amount. This is why annuitizing may have been uninviting for some clients. But, as mentioned earlier, annuity payments now count toward clients' RMDs for the year. If we use the same example as above, this is how it would look:

- Assume all the same financial information for River.
 - As mentioned above, River's RMD for this year would be \$40,485.83 using the Uniform Life Expectancy table factor of 24.7 for a 73-year-old.
- At age 70, River planned ahead to annuitize a portion of her IRA assets to supplement her income. For this example, let's assume the annual annuity payments from the contract total \$15,000.¹
- Before the SECURE Act 2.0, River's total RMD income for the year would be \$55,485.83. But after the passage of the SECURE Act 2.0 Section 204, the client may need to withdraw only \$25,485.83 from a non-annuitized account to satisfy the RMDs, as \$15,000 was already taken from the annuitized contract.

Put together, a QLAC may reduce the client's RMD obligation between ages 73 and 85 and satisfy a portion of the RMD for the qualified IRAs from the remaining deferred amount. This could reduce overall RMDs for non-annuitized accounts. Of course, each client's situation is unique. It is important for clients to work with legal and tax professionals to determine what might be appropriate.

Although there is still a need for regulatory clarification regarding how annuity payments count toward client RMDs and the specific value of the aggregate total fair market value (FMV) utilized, this regulatory update could be a game changer for some clients. As clients gather to commemorate Independence Day, remember that this is a prime opportunity to stress the importance of planning ahead to help ensure financial independence in retirement. Every client wants to enjoy the freedom of self-sufficiency, and for those goals to become realities, proactive planning is key.

ACTIONS YOU CAN TAKE RIGHT NOW

- **Identify clients with IRAs or qualified plans.**
- **Reach out to clients taking RMDs who want to lower income taxes.**
- **Discuss QLACs with clients focusing on income in the later years of retirement.**

¹Each insurance company offers different payout amounts and contract features. The example provided is hypothetical and for demonstrative purposes only.

Additional Resources and Links

[QLAC Case Study](#)

[Annuitizing a Traditional IRA](#)

[Trending Topics and Useful Strategies](#)

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please contact our Retirement Strategies Group at
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Annuity payments, withdrawals, and other distributions of taxable amounts, including death benefit payouts, will be subject to ordinary income tax. For nonqualified contracts, an additional 3.8% federal tax may apply on net investment income. If withdrawals and other distributions are taken prior to age 59½, an additional 10% federal income tax may apply. A withdrawal charge also may apply.

In order for the contract to be eligible as a QLAC, certain requirements under Treasury regulations must be met, including limits on the total amount of purchase payments that can be made to the contract. Qualified contracts, including traditional IRAs, Roth IRAs, and QLACs, are eligible for favorable tax treatment under the Internal Revenue Code (IRC). Certain payout options and features may not comply with various requirements for qualified contracts, which include required minimum distributions. Therefore, certain product features, including the ability to change the annuity payment start date, accelerate payments, and to exercise withdrawal features or payout options, may not be available or may have additional restrictions.

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