Annuity Ownership Considerations

We are always looking to provide solutions to our client's problems. So many times we are challenged by providing a solution to annuity ownership, which accomplishes the client's goals. This can result in additional issues relative to taxation, or the flow of money upon death of the owner, or upon a change of ownership during life. Below we will discuss ownership issues and provide guidance as to how best to structure annuity ownership.

Selecting an Owner

The annuity owner has control of the annuity contract during the life of the annuitant and before the maturity date. The owner can surrender the annuity contract, change the beneficiary, or make partial withdrawals from the annuity. Normally, there is one owner who purchases the annuity contract but other forms of ownership may be preferred depending on the goals and objectives of the owner.

Joint Ownership

The Tax Reform Act of 1986 amended IRC Section 72(s)(1), which now requires annuity contracts that have made no distributions to pay out five years after the death of the holder/measured life. If distributions have already started by death, the remaining portion must be distributed at least as rapidly as under the method of distribution being used at the date of death. However, if the surviving spouse is the designated beneficiary of the account, the surviving spouse is treated as the holder. Lastly, payments to a designated beneficiary must begin within one year of the date of death.

Many individuals enter into a joint ownership with a child to provide the child a benefit in the case of death. If, in the meantime, the annuity is surrendered, there will be two 1099s with any gain going equally to the parent and child. And, if the child is under age $59\frac{1}{2}$, they will also pay a 10% penalty tax on the gain. Lastly, when the parent dies, the entire amount will be included in the parent's estate with a gift being made to the child. The child will have the right to show what, if any, contribution they made to the account to reduce the value in the parent's estate. In the case of a married couple, one-half is included in each spouse's estate regardless of who contributed to the annuity.

Ownership by a Minor

If a parent or grandparent wants to make a minor the owner of an annuity, they would use the minor's social security number, with an adult custodian, so the account would read parent's name, custodian for child's name.

Ownership by a Non-Natural Owner

Many times an individual does not want to have themselves as owner, or even as beneficiary, so they want some other entity to hold ownership. IRC Section 72(u) states that an annuity contract loses its tax deferral if it is owned by a "Non Natural Person." Each year the income from the annuity is taxable, which pretty much eliminates the annuity as an investment option if such situations cannot be overcome. If placed in a trust, the trust must be structured so that the trust is holding the annuity for the benefit of a living person.

Naming a revocable living trust as owner may not be a good solution as income will normally be taxed as earned. If there is a spouse, the cleaner way is to make the spouse the beneficiary and the spouse can continue the annuity tax deferral at the first spouse's death.

Annuitant Issues

Normally, the annuitant and owner should be the same person. The death of the annuitant results in the annuity becoming a death benefit. If the owner is not the annuitant there should be a contingent owner of the policy in that if the owner predeceases the annuitant, the annuity continues. However, when the owner dies, the annuity must be paid out in five years unless the surviving spouse is the new owner.

Ownership Examples:

- Dad is a widower and wants to leave the annuity to his daughter upon his death. Dad is
 the owner and the annuitant and his daughter is the beneficiary. Dad should also consider
 giving daughter a Power-of-Attorney in the event Dad becomes incapacitated.
- Dad wants to buy an annuity and control it until his death and then benefit Mom and then
 the kids. Dad is the owner and annuitant and Mom is the beneficiary with the kids as
 contingent beneficiary.
- Grandma wants to buy an annuity to get a higher return on her money but is 76 years old, too old to buy one. Make Grandma the owner and her child the annuitant with Grandma being the designated beneficiary and the daughter the contingent beneficiary.
- Mom and Dad want to save for college for children but do not want the money to count against financial aid. Mom and Dad invest in an annuity with Dad (who will be 59 ½ when the child begins college) as owner and annuitant and daughter as beneficiary.
- If Grandma and Grandpa want to provide for child's college education, they can invest in an annuity with the parent as custodian and the grandchild as beneficiary.
- Many times, for future Medicaid planning, deferred annuities are used with joint ownership
 by Grandma and Grandpa so the spouse not going into the home can create a SPIA on
 their life. This would make the asset exempt for purposes of qualifying for Medicaid.

Everyone's situation is different. Individuals should consult their tax, investment, and legal advisors before entering into such a transaction.

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