Annuity Distribution Options for Your Beneficiaries

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Getting Started

Beneficiary distribution options tied to annuity assets may differ depending on the types of retirement assets as well as the relationship of the beneficiary to the owner.

There are two ways to categorize retirement assets—each with a unique set of taxation guidelines.

- **Nonqualified** (after-tax) funds may grow tax-deferred, although the contributions do not receive any initial income-tax deductions.
- **Qualified** (pretax) funds grow tax-deferred, and contributions are usually tax-deductible.

When these assets pass to your beneficiaries, it is important for you to understand the available distribution options, including those that offer continued tax deferral, to help beneficiaries avoid unnecessary taxes.

Consider a Pacific Life Variable Annuity

A variable annuity is a contract between you and an insurance company that helps you grow, protect, and manage retirement savings in a tax-advantaged way. It can help you:

- **Grow retirement savings faster** through the power of tax deferral.
- **Protect against inflation and market volatility** through a diverse choice of investment options.
- **Manage your investment strategy** by transferring among investment options free of tax consequences.
- **Convert your assets** to guaranteed, lifetime retirement income.
- **Leave a financial legacy** through a guaranteed death benefit.

Our variable annuities also offer features such as asset allocation and optional principal protection. Optional benefits are available for an additional cost.

Guarantees, including optional benefits, are subject to Pacific Life's financial strength and claims-paying ability and do not protect the value of the variable investment options, which are subject to market risk. The value of the variable investment options will fluctuate and, when redeemed, may be worth more or less than the original cost. Annuity 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 tax may apply. A withdrawal charge also may apply. Withdrawals will reduce the contract value and the value of the death benefits, and also may reduce the value of any optional benefits.

Distribution Options

The annuity distribution options available depend on the beneficiary's relationship to you and the type of funds—nonqualified or qualified—in the contract.

Nonqualified Deferred Annuity Death Benefit Distribution Options

	SPOUSAL BENEFICIARY	NON-SPOUSAL BENEFICIARY	TRUST BENEFICIARY
Lump Sum	✓	✓	✓
Five-Year Rule Distribute entire contract value within five years of the owner's death	✓	✓	✓
Lifetime Payments[1] Such as systematic withdrawals or annuitized payments	✓	✓ Not available for non-living beneficiaries (such as trusts, charities, and estates)	
Spousal Continuation Spouse becomes the new owner of the contract	✓		

[1]A post-death 1035 exchange of nonqualified assets may be available for beneficiaries. In private letter ruling (PLR) 201330016, a taxpayer was allowed a tax-free 1035 exchange of the death proceeds from five deferred annuity contracts to a new variable annuity contract. It is important to understand, however, that a PLR is directed only to the taxpayer who requested it, and not all annuity companies may process the transaction.

Qualified IRA Death Benefit Distribution Options

If an IRA owner dies before or after the required minimum distribution (RMD) beginning date (generally age 70½), beneficiaries have the choice of any of the following options to take distribution of their individual interest in the death benefit.

IRA Owner's Death Occurs before the RMD Beginning Date

These options are also available for Roth IRA beneficiaries.

	SPOUSAL BENEFICIARY	NON-SPOUSAL BENEFICIARY	TRUST BENEFICIARY
Lump Sum	✓	✓	✓
Five-Year Rule Distribute entire contract value by December 31 of the fifth year following the year of the IRA owner's death	✓	✓	✓
Lifetime Payments Such as systematic withdrawals or annuitized payments	✓ Beginning no later than the end of the year the owner would have turned age 70½	✓ Paid over the beneficiary's life expectancy	✓[1] Paid over the oldest beneficiary's life expectancy
Rollover to Individual IRA	✓		

IRA Owner's Death Occurs on or after the RMD Beginning Date

	SPOUSAL BENEFICIARY	NON-SPOUSAL BENEFICIARY	TRUST BENEFICIARY
Lump Sum	✓	✓	✓
Lifetime Payments Such as systematic withdrawals or annuitized payments	✓	✓ Paid over the longer of the beneficiary's or owner's life expectancy	✓[1] Paid over the longer of the oldest beneficiary's or owner's life expectancy
Rollover to Individual IRA	✓		

[1]Trust must meet the following conditions: (1) valid under state law, (2) irrevocable, or became irrevocable upon the death of the IRA owner, (3) the beneficiaries of the trust are identifiable from the trust instrument, and (4) copy of the trust document or certified list of all beneficiaries, including contingent and remaindermen, must be supplied to the IRA provider by October 31 of the year following the year of the IRA owner's death.

The Power of Tax Deferral

When your beneficiaries choose a distribution option, it is important to consider the power of tax deferral. By allowing earnings to grow without taxation each year, your beneficiaries may receive a larger financial legacy.

Below is a hypothetical example using death benefit proceeds from a nonqualified contract. The example assumes a basis equal to $100,000 with annuity payments of $16,576 per year for the Single Life option (male). Keep in mind, the additional 10% early distribution federal tax does not apply to distributions to beneficiaries, and an annuity is not the only way for IRA growth to receive tax deferral.

Mark is age 65, currently pays federal income taxes at a rate of 28%, and inherits $266,583. If he chooses a lump-sum distribution, after income taxes he will receive $219,939.

If Mark chooses to annuitize for his lifetime, he would receive:

- **$265,297 after tax over a 20-year period.**

- **$384,645 after tax over a 30-year period.**

Actual tax rates may vary for different taxpayers and assets from those illustrated (for example, capital gains and qualified dividend income). Actual performance of your investment also will vary. Lower maximum tax rates on capital gains and dividends would make the investment return for the taxable investment more favorable, thereby reducing the difference in performance between the examples shown. Consider your personal investment time horizon and income-tax brackets, both current and anticipated, when making an investment decision.

Hypothetical returns are not guaranteed and do not represent performance of any particular investment. If variable annuity charges were included (withdrawal charges, mortality and expense risk charges, administrative fees, and other contract charges), the tax-deferred performance would be significantly lower.

IRAs and qualified plans—such as 401(k)s and 403(b)s—are already tax-deferred. Therefore, a deferred annuity should be used only to fund an IRA or qualified plan to benefit from the annuity's features other than tax deferral. These include lifetime income, death benefit options, and the ability to transfer among investment options without sales or withdrawal charges.

To learn more about beneficiary distribution options, please talk to your financial and tax advisors today.

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