Annuity Insights: Summary

THE INS AND OUTS OF ANNUITY TAXATION

Understanding the tax treatment of annuities

In this episode, wealth expert Michael Finke is joined by Steve Parrish of The American College and Justin Bateman of New York Life to tackle one of the most misunderstood topics in retirement planning: annuity taxation. They break down key rules and strategies across qualified and non-qualified accounts, helping advisors guide clients with greater clarity.

Tax deferral and its strategic value

Non-qualified annuities offer tax-deferred growth, functioning as retirement-focused investments. Unlike FDIC-insured CDs or fixed income bonds, earnings in an annuity aren't taxed annually—they're taxed only when withdrawn, creating strategic flexibility in retirement income planning.

Annuitization vs. withdrawals

Annuitized contracts benefit from the exclusion ratio, allowing clients to receive a portion of each payment as a return of principal—reducing immediate tax liability. In contrast, lifetime withdrawals (GLWBs) are taxed using the LIFO method: gains come out first, often increasing tax burden in the early years of retirement.

Planning around taxable income

The team highlights how advisors can use annuities to manage taxable income—especially during low-income years or before RMDs begin. They caution that poorly timed GLWB withdrawals can affect Medicare premiums and overall tax brackets if not properly managed.

Tax strategies at death

Annuity taxation upon death varies by contract and ownership structure. While spousal continuation is common, non-spousal beneficiaries may face unexpected tax hits—though strategies like the "non-qualified stretch" and 1035 exchanges into inherited annuities may offer planning advantages.

Final thoughts

Annuities are powerful tax-advantaged tools—but only if used correctly. By understanding the differences in how income and death benefits are taxed, advisors can help clients avoid tax pitfalls and unlock the full value of their annuity strategy.

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