

# Nonqualified Annuity Stretch Payouts

## Frequently Asked Questions

### **What is a nonqualified annuity “stretch payout”?**

A “Stretch”, as it is often called, is the method in which the death benefit from a nonqualified annuity is paid out over a period of time based on the life expectancy of the beneficiary. Beginning in **March 2008**, beneficiaries can choose to elect to “stretch” payments over their lifetime rather than receive the entire death benefit in one lump sum or within five years of the owner’s death. The owner must have died prior to his or her annuity start date before a beneficiary can elect the stretch option.

### **Can any beneficiary of a nonqualified annuity choose to stretch the death benefit?**

Stretch Payouts typically apply to non-spouse beneficiaries, but they are often initiated by a spouse beneficiary “continuing the policy” after the death of the original policy owner. At the time of the policy’s continuation, the spouse beneficiary can select his or her own beneficiary. At the surviving spouse’s death, the selected beneficiary can elect to take the death benefit within five years or elect (within a one-year time frame) to begin stretch payments over his or her life expectancy based on the policy’s stretch payout guidelines.

### **How does Old Mutual calculate stretch payments?**

The calculation is based on the Policy Value divided by the Life Expectancy Factor (reduces by one each year after the first year):

$$\frac{\text{Policy Value}}{\text{Life Expectancy Factor}}$$

### **When is the policy value determined?**

The policy value is initially determined on the date of the first payment. For each year thereafter, it is the policy value on December 31<sup>st</sup> of the prior year.

### **When is the life expectancy factor determined?**

The factor is determined based on the beneficiary’s age on the date of the first stretch payment. It is then fixed on that date. Each year following, one is subtracted from that initial factor for use in the calculation formula. (This formula is used for non-spouse beneficiaries. A spouse beneficiary who elects to take payments rather than continue the policy is eligible to use a “recalculation formula” which differs from the formula non-spouse beneficiaries must use.)

### **Is the stretch payout the same each year?**

The stretch payment will vary from year-to-year based on the policy value and the life expectancy of the beneficiary as determined each year.

### **How often must the beneficiary withdraw money from the policy?**

The first annual payment must be withdrawn by the first anniversary date of the owner’s death. Each year following the initial annual withdrawal, the annual payment must be taken by December 31<sup>st</sup> of each subsequent year.

### **Can the stretch payment be withdrawn in installments?**

Installment withdrawals may be permitted, provided the initial stretch payment is taken entirely by the first anniversary of the owner’s date of death and each succeeding stretch payment is withdrawn in full by December 31<sup>st</sup> of each subsequent calendar year. OM Financial Life Insurance Company offers monthly, quarterly, semi-annual and annual payment frequencies for stretch payouts.

### **Can a beneficiary withdraw additional money from the annuity?**

Yes, however, if the owner elected a settlement option for the beneficiary prior to dying, the beneficiary cannot change the predetermined amount and payout schedule. If a settlement option was not elected by the owner, the beneficiary may make the stretch election and may also take additional withdrawals when necessary. The “stretch” is the MINIMUM amount one must take to comply with Internal Revenue Code requirements for taking lifetime payouts.

## Nonqualified Annuity Stretch Payouts Frequently Asked Questions

### **Can a beneficiary receiving stretch payments from the annuity policy contribute additional money to the policy?**

No. The beneficiary owns only an interest in the death benefit and cannot exercise any other rights under the policy.

### **What are the consequences for failure to withdraw a stretch payment?**

The beneficiary will not be permitted to stretch the death benefit if he or she fails to withdraw the first annual stretch payment amount by the first anniversary date of the owner's death. There will be negative tax consequences if the beneficiary does not withdraw a full year's stretch payment by the deadline of December 31<sup>st</sup> of the calendar year each year after the first. If a stretch payment is missed, the entire value of the annuity policy in excess of the investment in the policy (cost basis), if any, may become taxable.

### **Can a stretch payout interest be 1035 exchanged to another insurer?**

No. There is no statutory authority permitting a beneficiary of death benefit interest to exchange that interest for a similar interest elsewhere. The provision applicable to beneficial interests in qualified plans and IRAs does not apply to nonqualified annuities, at least not at this time.

### **What happens if a beneficiary who elects a stretch payout dies before receiving the entire proceeds?**

The original beneficiary has the right to designate a successor payee to receive the remaining value of any payments due to the original beneficiary. If a successor payee is named, the payments will continue to that person in the same fashion and amount as they were being paid to the original beneficiary. If no successor payee is named, remaining proceeds will be paid to the estate of the original beneficiary.

### **A word of caution!**

A client contemplating employing a stretch payout election should talk with his or her personal tax advisor to be sure he or she understands the rules and the tax implications of failing to follow the rules. The information discussed here is general in nature. For specific advice based on specific facts and circumstances, clients should seek the advice of a qualified professional tax advisor.

**Stretch payouts for nonqualified annuity death benefits... another option you can talk to your clients about beginning in March 2008!**