Are you leaving behind a tax burden?

IRA Strategies

The dilemma

Many people who have been successful saving for retirement have established a large enough nest egg to create a legacy for their children, grandchildren and favorite charities; leaving them to wonder how to best leverage their qualified or tax-advantaged retirement plans. A common concern is whether financially successful retirees should make their children the beneficiaries of their IRA, leaving a likely income tax burden.

Over the next 20 years, an estimated $90 trillion will change hands from aging households to their heirs and charity.[2]

Tax saving alternatives using life insurance

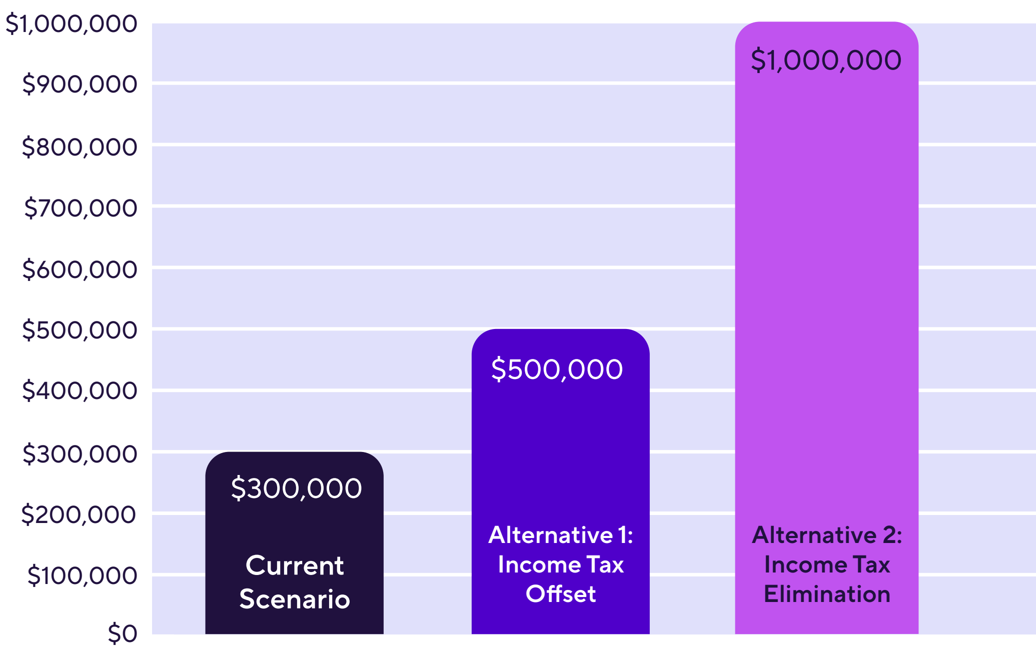
If an IRA owner is looking to protect loved ones and to help maximize wealth transfer, he/she can utilize life insurance to help minimize the tax burden that inheriting an IRA may impose on a beneficiary. With two different strategies identified in this brochure, individuals can help **maximize the after-tax** value of their inheritance or even **eliminate taxes paid** on the IRA inheritance.[1]

The chart below provides a hypothetical comparison of what IRA distributions look like on the same IRA account before ("Current" bar) and after ("Tax Offset" and "Tax Elimination" bars) the two solutions were used. These strategies can help offset or eliminate the tax burden on the beneficiaries, maximize the amount of money beneficiaries receive and provide greater flexibility in how the assets are ultimately put to use.

After-tax benefit amounts

Comparison of wealth transfer alternatives for a $500K IRA

This chart illustrates the potential benefits of the two alternatives discussed on the following pages, compared to leaving the IRA to your children. Policy owners should undertake planning with the assistance of legal, financial or tax advisors.



Fees and charges, if applicable, are not reflected in this example and would reduce the IRA amounts shown. This chart does not take into account any costs associated with the purchase of the life insurance policy on the net wealth of the policy owner(s).

What will an IRA be worth when transferred?

If you plan to pass IRA assets to a beneficiary, proper consideration should be given to IRA required minimum distributions and the resulting effect these can have on the amount a beneficiary may inherit upon the IRA owner's death.

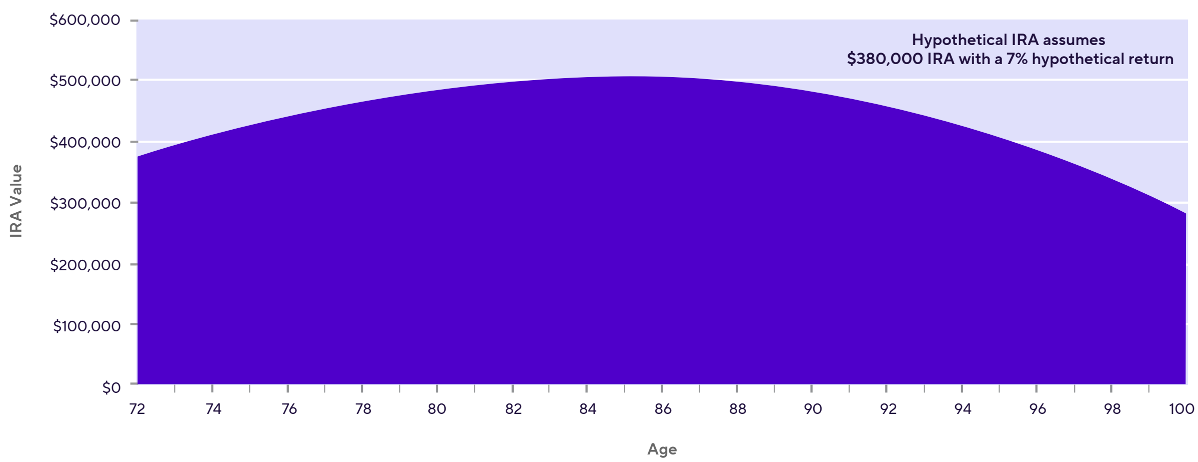
- Depending on the IRA owner's date of birth, at some point in their 70's they'll be required to withdraw an increasing percentage of an IRA's account value each year until the IRA is exhausted – "Required Minimum Distribution (RMD)."
- Eventually RMDs will be larger than the expected annual interest growth. When that happens, the IRA may well be at its peak value, typically between ages 85 and 90, as depicted in the chart below.[3]
- When an IRA owner dies, the beneficiary must include taxable amounts received in his or her gross income.

It is not uncommon for retirees to die sometime between their 75th and 95th birthday. As the graph below depicts, when that happens IRAs are often passed to the next generation at-or-near peak values. Because these IRA inheritances are fully taxable to the beneficiaries as ordinary income, they may be taxed at very high rates.

Hypothetical IRA peak value estimation

Due to annual growth and Required Minimum Distributions

Let's take a look at a hypothetical example of an IRA valued at $380,000 at age 72, assuming that RMDs also begin at age 72. With an estimated annual growth of 7% and Required Minimum Distributions* taken out every year, you can see the estimated curve in the values over time. At age 85, the estimated value is approximately $500,000.



Fees and charges, if applicable, are not reflected in this example and would reduce the amount shown. Income taxes on tax-deferred accounts are payable upon withdrawal, including RMDs. This hypothetical example does not reflect the return of any specific investment and is not a guaranteed of future value or results

*The rules governing RMDs are complex and subject to modification. Individuals should seek the advice of an independent tax advisor or attorney for more complete information concerning their particular circumstances.

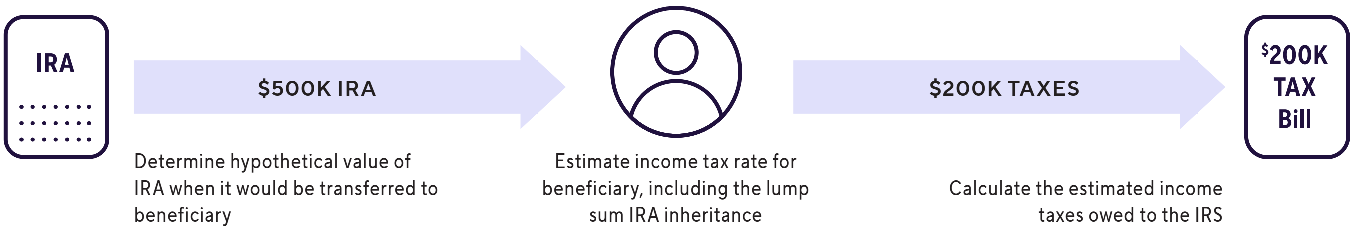
Innovative alternatives for IRA legacy

The two solutions described here may help reduce or eliminate the taxes imposed on an IRA beneficiary, thus helping maximize the value of the inheritance.

"Current" Scenario It is not uncommon for an IRA owner to use other portfolio assets for retirement and living expenses, passing on the majority of the IRA balance (along with the tax liability), to the beneficiary at the owner's death.[4]

- At IRA owner's death, the IRA balance is paid to the beneficiary
- Income taxes are due on the IRA amounts received by the beneficiary[5]
- If a beneficiary is in his/her 50's and 60's at IRA owner's death, potentially earning his/her highest career income, he/she may pay taxes in a high income tax rate. The addition of IRA inheritance to beneficiary's existing taxable income could push the recipient into a higher tax bracket.
- This can result in excessive income taxes to the beneficiary, reducing the net value of his or her inheritance — see diagram below for an example.

Estimating tax impact of IRA inheritance



Estimated IRA value at owner's age 85 = $500K **x** 40% estimated income tax rate **=** Beneficiary $200K tax burden; $300K net inheritance.

Option 1: Offset IRA beneficiary income taxes

Options include the purchase of a life insurance policy equal to the anticipated income tax due from beneficiary at projected time of inheritance. Life insurance benefit may be used to pay the income tax due, maintaining the full value of the IRA legacy.

IRA Income Tax Offset Solution

Estimated IRA value at owner's age 85 = $500K **x** 40% estimated income tax rate **=** Beneficiary owes $200K taxes $500,000 net inheritance

RESULTS: Beneficiary receives life insurance death benefits, generally **income tax-free**, and can use those funds to pay the taxes due on IRA inheritance.[6]

- The beneficiary receives $500,000 ($300,000 net of taxes from IRA and $200,000 from life insurance death benefits). Beneficiary then has discretion to invest/use full value associated with the IRA funds.

Option 2: Eliminate IRA beneficiary income taxes

By incorporating a charity and funding a life insurance policy for beneficiaries, the federal taxes on the distribution of an IRA may be completely eliminated.

IRA Income Tax Elimination: Charitable Bequest

Estimated IRA value at IRA owner's age 85 $500,000

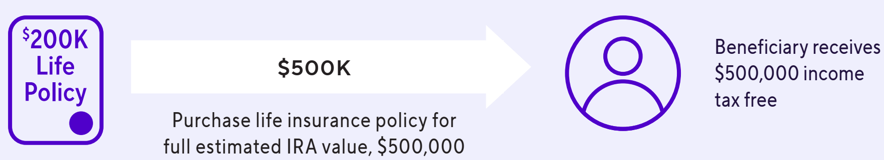
Charitable beneficiary is tax exempt $500,000 IRA proceeds tax-free

Part 1

Name a tax-exempt charity as the IRA beneficiary. With the charity's tax exempt status, no taxes will be due on the inherited IRA funds.

See example at left:

IRA Income Tax Elimination: Life Insurance Legacy



Life insurance benefit $500,000

Benefits received at death $500,000 income tax-free proceeds

Part 2

To prevent disinheriting the beneficiary, purchase a life insurance policy equal to the estimated peak value of the IRA. The beneficiary would receive the life insurance death benefit income tax-free under the current tax law.[6]

See example at left:

RESULTS: Total wealth transferred ($1,000,000) is more than three times the amount of net after-tax IRA inheritance in the current scenario ($300,000), and the income taxes have been eliminated.

- Beneficiary of life insurance policy receives full $500,000 death benefit (equal to estimated IRA value), generally, income tax-free.6
- Charitable beneficiary receives full $500,000 value of IRA income tax-free (at IRA owner's death)
- Zero Federal income taxes are paid on either the IRA or the life insurance policy

It is important to note that life insurance policies differ and are subject to premiums and fees. Please speak to an appropriately licensed insurance professional for more information.

[1] American General Life Insurance Company and their distributors and representatives may not give tax, accounting or legal advice. Any tax statements in this material are not intended to suggest the avoidance of U.S. federal, state or local tax penalties. Such discussions generally are based upon the company's understanding of current tax rules and interpretations. Tax laws are subject to legislative modification, and while many such modifications will have only a prospective application, it is important to recognize that a change could have retroactive effect as well. Individuals should seek the advice of an independent tax advisor or attorney for more complete information concerning their particular circumstances and any tax statements made in this material.

[2] The Wealth Report 2024, 18th Edition, 2024.

[3] Depends on life expectancy factors, the assumed annual rate of return and additional deposits or withdrawals made.

[4] Depending on the beneficiary's circumstances, the requirements vary regarding when a beneficiary must take distributions from their inherited IRA. Please check with qualified tax and legal advisors for details.

[5] Under the SECURE Act, "Designated Beneficiaries" may defer taxes on their inherited IRA for up to 10 years. Some beneficiaries will be subject to different distribution requirements. Additionally, a surviving spouse beneficiary may transfer the IRA into his/her own name and delay distribution until age 72, for spouses born after June 30, 1949. However, the taxable portion of the IRA at date of death will ultimately be subject to federal income. For advice concerning your individual circumstances, consult your attorney, tax advisor, or accountant.

[6] Life Insurance death benefits are generally tax-free for beneficiaries under IRC101(a), but may be taxable in part or whole under certain situations. For advice concerning your individual circumstances, consult your attorney, tax advisor, or accountant.

For more information, contact your financial professional.

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