



 **You Inherited An IRA... Now What?**



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Any reference to an “IRA” refers to an “**Individual Retirement Account**”  
rather than an “**Individual Retirement Annuity**.”  
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Hello... today let's talk about an entirely new opportunity brought-about by **The SECURE Act**.

As we move forward, many people will inherit IRAs. But under **The SECURE Act**, what happens next, and what options do you have as the IRA beneficiary?

Let's see how it works, and where life insurance fits.

*(As a footnote, please be aware that any reference to an **IRA** in this presentation refers to an “**Individual Retirement Account**” rather than an “**Individual Retirement Annuity**.”)*

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2

Before we get started, please review these important notes about today's discussion.

## January 1, 2020: *The SECURE Act*

*“The most sweeping retirement legislation in a long time”*

### Changes specific to IRAs:

- You can contribute to an IRA beyond age 70½ (*must have earned income*)
- RMD's moved from age 70½ to age 72 (*if you turn age 70½ in 2020 or later*)
- Inherited IRAs must be fully distributed within 10 years (*some exceptions apply*)
  - ✓ Includes inherited Roth IRAs (*no tax on the Roth distributions*)
  - ✓ No more “**stretching**” over beneficiary's life expectancy (*some exceptions apply*)



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3

The world has changed again, and *The SECURE Act* has made some notable changes.

In fact, it's being considered the most sweeping retirement legislation in a long time.

In addition to encouraging retirement savings for small-businesses, *The SECURE Act* also made some changes to IRAs. Here are a few key points:

- Prior to *The SECURE Act*, you were NOT allowed to contribute to an IRA after age 70½, even if you had earned income. This was always puzzling because several other retirement plans allow contributions after age 70½, up until the employee separates from service (*typically at retirement*). *The SECURE Act* now allows IRA contributions past age 70½, putting it on a more even keel with other retirement plans. But note that you can only continue contributing to your IRA if you have earned income.
- RMD's, which used to begin the year after turning 70½, now don't need to begin until April 1 of the year following the year you turn age 72 (*this applies if you turned 70½ in 2020 or later*).

- The third thing we'll talk about today, and perhaps the most consequential, is that **The SECURE Act** eliminated "stretch IRAs" for non-spouse beneficiaries (typically kids and grandkids) (*some exceptions apply*). Under the new rules, Inherited IRAs must be fully distributed within 10 years of the date they're inherited. And, in traditional IRAs, where all of the contributions have been done on a pre-tax basis, the entire IRA account will be taxable. This could have HUGE implications for beneficiaries inheriting large IRAs. Keep in mind that, under **The Secure Act** there are no RMDs during the first 9 years after an IRA is inherited. **The SECURE Act** simply stipulates that all of the money needs to come out of the inherited IRA within 10 years. So, many investors will wait the full 10 years, preserve their tax-deferral as long as possible, take all of their money out of the Inherited IRA at the last minute, and pay taxes on the entire amount in one tax year. Imagine inheriting a \$2 million IRA. During the next 10 years it grows to \$3 Million. And then you pay tax on the entire \$3 Million in one year. What will your tax bracket be in that year?

*(Be aware that exceptions exist to the 10-year rule under **The SECURE Act** for certain IRA beneficiaries.)*

*(Throughout the balance of this presentation, when we refer to IRA beneficiaries, we're referring to "**Designated Beneficiaries**" and we're not referring to "**Eligible Designated Beneficiaries.**"*

**Designated Beneficiaries** are the group subject to the new 10-year rule.)

## Did We See This Coming?

### 2017 Congressional Budget Proposal

#### IRAs are a retirement asset, NOT a legacy asset

*“The Code gives tax preferences for retirement savings accounts primarily to provide retirement security for individuals and their spouses... **The preferences were not created with the intent of providing tax preferences to the non-spouse heirs of individuals.**”*

*(direct quote from the 2017 Budget Proposal)*

See <https://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2017.pdf>; page 165



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4

Did we see this coming... the elimination of the IRA Stretch provision?

Well, if you look back at the 2017 Congressional Budget Proposal (as well as in prior years), you'll see that the IRS has taken the position that IRAs are a retirement asset, NOT a legacy asset.

In fact, they specifically wrote that: ***“The Code gives tax preferences for retirement savings accounts primarily to provide retirement security for individuals and their spouses... The preferences were NOT created with the intent of providing tax preferences to the non-spouse heirs of individuals.”***

So clearly, for many years, Congress has been cautioning us that IRA Stretching was at-risk of disappearing.

See <https://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2017.pdf>; page 165

The IRS considers IRAs to be a “retirement asset”, not a “legacy asset.”

Let's explore how **The SECURE Act** might affect inherited IRAs in the future.

## January 1, 2020: *The SECURE Act*

Projected Value  
5.25% projected growth; 40% projected tax in year 10

This scenario is completely hypothetical and is not intended to represent any particular situation or IRA.



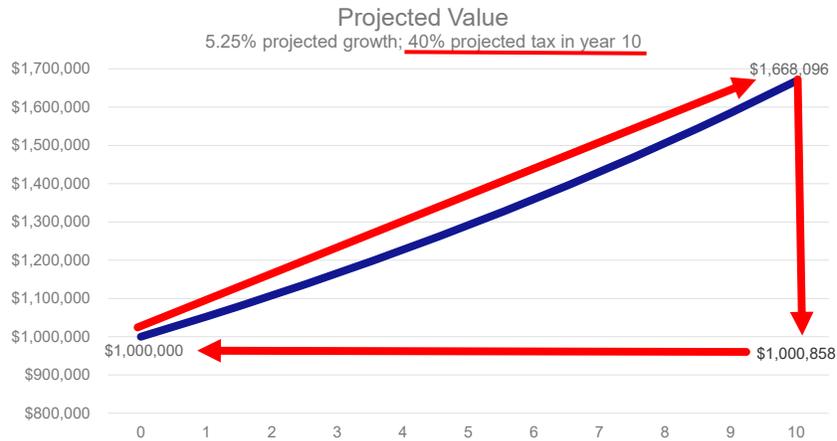
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5

Let's talk about what ***could happen*** to an inherited IRA.

Here's what could happen to a hypothetical \$1,000,000 inherited IRA if it was allowed to grow at a hypothetical rate of 5.25% for 10 years, and then the entire IRA is distributed and taxed in the 10<sup>th</sup> year.

## January 1, 2020: *The SECURE Act*



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6

In the 10<sup>th</sup> year this example assumes the 5.25% growth is added, increasing the IRA to \$1,668,095 at the end of 10 years, then the 40% tax is subtracted, bringing the balance down to \$1,000,858.

It's interesting to note that 5.25% is an approximate break-even rate of return. If you continued the tax-deferral for the entire 10 years and took the money out of the Inherited IRA in the 10<sup>th</sup> year, the after-tax value is almost identical to the starting value from 10 years earlier.

So you'd need something greater than a 5.25% compound annual rate of return (after all fees and charges) to end up with more money than you started with.

## Where Do We Go From Here?

Many IRA beneficiaries are concerned about the imminent taxes on their inherited IRA... is that a concern for you?

I'd like to talk about your **SECURE Act** concerns  
by discussing a unique idea  
that can protect your inheritance from taxes  
after it's distributed from your IRA.



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7

So where do we go from here?

I visit with a lot of people, and lately I'm hearing a consistent theme:  
May IRA beneficiaries are concerned about the imminent taxes they'll owe on  
their inherited IRA within 10 years of their inheritance... Is that a concern for  
you?

That's why I'd like to visit with you today.  
I'd like to talk about your **SECURE Act** concerns by discussing a unique idea  
that can protect your inheritance from taxes after it's distributed from your IRA.

## Key Points:

### 1. You inherited (or will inherit) an IRA

That's a great windfall, but...

➤ **TAXES, TAXES, TAXES!**

### 2. Revisit the *Roth Conversion*

### 3. “**Convert**” your Inherited IRA?



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8

So let me describe what we'll discuss today:

1. First we'll talk about the concept that either you inherited (*or you expect to inherit relatively soon*) an IRA. That's good news and bad news. The good news is that you inherited a significant legacy. The bad news is that it comes with a lot of potential taxes.
2. Then we'll revisit the concept of Roth Conversions; and finally
3. We'll talk about whether an IRA beneficiary can do a Roth Conversion of their inherited IRA and, if not, what options they have.

So if you're ready, let's get started by talking about point number 1...  
You inherited... or expect that you will soon inherit... an IRA.



# 1. You Inherited An IRA



First let's talk about "the good news and the bad news" about your IRA inheritance.

# 1. You Inherited An IRA

## A. *The SECURE Act*

- Inherited IRAs must be fully distributed... and taxed... within 10 years
- No more “**stretching**” (*some exceptions apply*)

## B. Lump-sum taxes in the 10<sup>th</sup> year could be significant:

- A significant 1-year increase in AGI... IRA value could nearly double!
- You could be pushed into a higher marginal tax rate
- Could lose 35% – 40% to Federal income taxes
- Could lose even more to State income taxes

## C. What are you gonna do with the \$\$\$ **after** you pay the taxes?

- Reinvest it into your Non-Qualified portfolio?
- Keep paying taxes on the growth for the rest of your life?



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10

The good news is that you inherited a significant financial asset.

However, under **The SECURE Act**, the entire value of your inherited IRA must be distributed... and all of the distributions taxed... within 10 years of inheriting the IRA.

So there's no more “stretching.” (*some exceptions apply*)

You might ask “**What's IRA Stretching?**”

Under the rules prior to **The SECURE Act** the beneficiaries were able to take small distributions from their inherited IRAs, spread out over their life expectancy, and defer much of the tax for a very long time.

But under **The SECURE Act**, IRA Stretching is no longer allowed for most beneficiaries (*some exceptions apply*).

So what might people do with their inherited IRAs?

Well, there's no requirement under **The SECURE Act** to take out any distributions during the first 9 years after inheriting the IRA. So many beneficiaries might just leave it alone and let it grow, deferring the taxation as long as possible.

But that means ALL OF IT must be distributed in the 10<sup>th</sup> year.

Imagine if you inherited a \$1,000,000 IRA. If it grew by just 6% per year, ten years later it would be worth nearly \$1.8 million. Imagine adding \$1.8 million to your taxable income 10 years from now. What tax bracket would you be in? You obviously could be facing a very hefty tax bill, and for reasons you might not be thinking about.

Adding that much money to your taxable income in one year could easily push you into a higher marginal tax bracket.

Consequently you could lose upward of 35% to 40% of the inherited IRA to Federal income taxes alone, and you could have state income taxes on top of that!

And then what happens?

Let's say you paid 40% tax on your inherited IRA. You'll have around \$1 million left.

Will you reinvest it in your non-qualified portfolio?

If you do that, you will likely keep paying taxes on the growth every year, potentially for the rest of your life.

As you can see, the good news is that you inherited a nice financial legacy. But the bad news is the taxes you'll owe, and that can be a very difficult pill to swallow.



## 2. The Roth Conversion



Next let's revisit Roth Conversions.

## 2. The Roth Conversion

*Everything you convert gets taxed, but...*

*You may never pay tax on it again!*

*Your beneficiaries may not pay tax on it, either!*

*Why don't people convert?*



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12

The challenge of a Roth Conversion is that you must pay taxes on the amounts converted.

But once it has all been taxed and converted, you may never pay taxes on that money again.

That's because all growth inside of a Roth IRA occurs income tax deferred; all distributions are income-tax-free; and there are no requirements to take distributions from a Roth IRA.

So the question is: If converting to a Roth IRA is such a good idea, why don't people do it?

Often the answer is: ***Because they don't want to pay the tax.***



### **3. Convert Your Inherited IRA?**



We know that IRA owners can do Roth Conversions anytime they want.  
So why don't they?

Because they're reluctant to pay the taxes caused by the conversion.

### 3. Convert Your Inherited IRA?

*IRA owners can convert to a Roth IRA, but...*

*IRA beneficiaries CANNOT convert to a Roth IRA*

*Is there another way?*



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14

But what about IRA **beneficiaries**?

Can an IRA beneficiary do a Roth Conversion of their inherited IRA?

Unfortunately, whereas IRA owners **can** do Roth Conversions, IRA beneficiaries **cannot**.

But is there another way?

Is there an alternative that an IRA beneficiary can pursue that can give them something similar, especially if they can benefit from additional life insurance?

Let's see.

## ***The Life Insurance Alternative***

### **3 Easy Steps:**

1. 10 equal annual distributions to liquidate the Inherited IRA
2. Apply after-tax distributions as premiums to a Life Insurance Policy
3. Compare the results



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15

What if, instead of paying tax on the distributions and doing a Roth Conversion (*which they can't do*), they did this:

First, when an IRA is inherited, the beneficiary could take 10 equal annual distributions designed to liquidate the Inherited IRA over a 10 year period of time.

Second, apply the after-tax value of these distributions from the inherited IRA as premiums paid into a life insurance policy. This gives the beneficiary the additional life insurance they need, and an opportunity for the cash value to grow income-tax deferred, without any RMD requirements, and without any income tax to the subsequent beneficiaries upon the death of the initial beneficiary.

Third, compare the projected life insurance account values vs. reinvesting the distributions from the inherited IRA into taxable non-qualified investments.

## ***The Life Insurance Alternative***

Male, age 50 PNT; 10-Pay Premium = \$51,200 (\$64,000 – 20% tax); Initial DB: \$705,911

This scenario is completely hypothetical and is not intended to represent any particular situation or IRA.

Remember that access to the values of these two alternatives are very different. The reinvested IRA will have cost basis. Growth is typically taxed annually, while the rest of the values that represent cost basis can be accessed without taxation. The life insurance policy cash values can be accessed using policy loans and withdrawals. Structured correctly, these cash values can be accessed without current income tax. Policy cannot be a Modified Endowment Contract (MEC) Please consult a qualified tax advisor before making any decisions about an IRA or life insurance policy.



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16

In a moment I'll show you a simple graph showing the comparison of account values using AIG's Max Accumulator+ II IUL policy projected at an assumed interest rate of 6%.

But first let's review some of our assumptions shown in the graph title

I assumed a 50-year-old male, preferred-non-tobacco inheriting a \$500,000 IRA from his parents.

Based on the earnings in the IRA, we were able to project liquidating it over a 10 year period of time... 10 equal after-tax distributions.

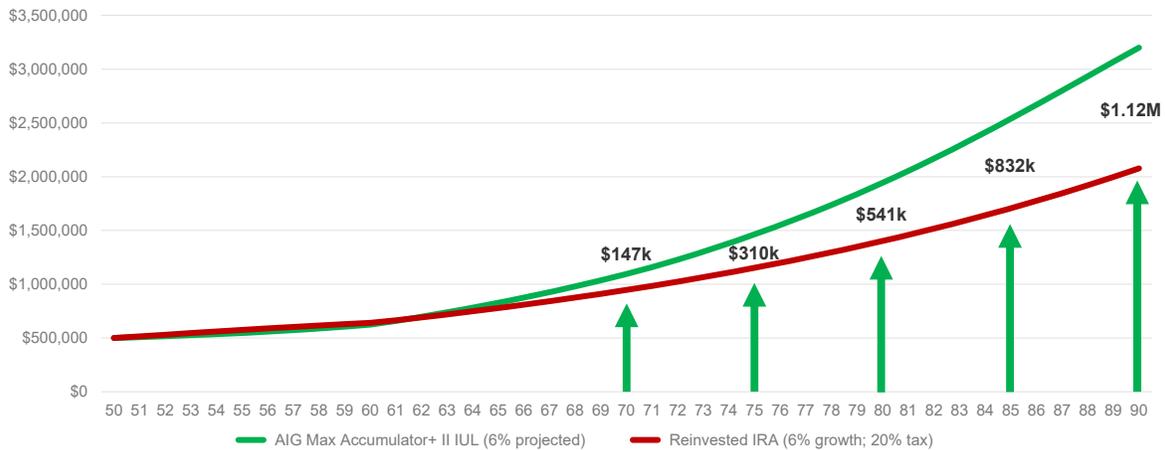
*(Calculation Notes: With a 6% growth rate, and distributions taken at the beginning of each year (because life insurance premiums need to be paid at the beginning of the year), annual pre-tax distributions of \$64,000 liquidate the account in 10 years. Subtract 20% tax to get "net" after-tax distributions of \$51,200)*

After subtracting the income taxes from the distributions, we projected an annual after-tax inherited IRA distribution of \$51,200 which could be used for life insurance premiums for 10 years, and after 10 years the inherited IRA would be empty.

When we solved for the minimum death benefit using Max Accumulator+ II IUL, the death benefit was \$705,911 (*as of 10/27/21*).

## The Life Insurance Alternative

Male, age 50 PNT; Initial DB: \$705,911; 10-Pay Premium = \$51,200 (\$64,000 – 20% tax)



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17

In the red line of the graph you can see the projected value of the alternative hypothetical account. During the 10 years of liquidation the IRA was assumed to grow at a constant 6% rate with no taxes on the growth that remained inside of the IRA. The funds distributed from the IRA were taxed at 20%, and assumed to be reinvested into a taxable account, which was also projected at a 6% growth rate with a 20% tax rate.

In the green line you can see the Account Value of the Max Accumulator+ II IUL policy (as of 10/27/21).

During the first 10 years of the comparison, the Max Accumulator+ II Account Value was added to the remaining pre-tax balance in the IRA. The Max Accumulator+ II IUL is projected at a 6% level interest rate in all years, and includes the 65 basis-point Account Value Enhancement in years 6+, for a total projected interest rate of 6.65% in years 6+.

As you project these values out, you can see the difference in projected values... the Max Accumulator+ II over the reinvested after-tax IRA funds.

By the end of the 15<sup>th</sup> year... at age 65... you can begin to see the values diverge.

- By age 70 the projected IUL account value is \$147,000 higher than the projected hypothetical non-qualified account value.
  - At age 75 the difference increases to \$310,000.
  - At age 80 the difference is \$541,000.
  - At age 85 (*which many would consider to be an approximate average life expectancy*), the Reinvested IRA account is projected to be at about \$1.7 million, while the projected Max Accumulator+ II policy is projected to have a little more than \$2.5 million.... A difference of about \$832,000.
- Even if you liquidated the entire life insurance policy value at age 85 and paid 30% tax on the gains in the policy, the resulting after-tax value would be just under \$2 million, which is still more than the approximately \$1,706,000 that the hypothetical investment is projecting at age 85.
  - And you can access a large portion of the account value by using income-tax-free policy loans and withdrawals, and leave the residual value as an income-tax-free legacy.
  - And the life insurance death benefit... the legacy left to the family... is always equal-to or greater-than the account value. So if it turns out that you don't actually need to access this money during retirement, it can become a significant family legacy.

At age 90 the Max Accumulator+ II IUL projected value exceeds the hypothetical projected non-qualified account by about \$1.1 million.

This example suggests a very compelling argument for liquidating the Inherited IRA over 10 years and, instead of reinvesting the after-tax distributions into a non-qualified portfolio, it might make sense to use the after-tax distributions as premiums into a life insurance policy.

## ***The Life Insurance Alternative***

1. Your inherited IRA is a windfall, but...
  - ***TAXES, TAXES, and more TAXES!***
2. As an IRA Beneficiary, you must pay taxes on the entire account balance (*just like you'd have to do for a Roth Conversion*), but you cannot “convert” those Inherited IRA distributions to a Roth IRA.
3. Consider doing a “***Life Insurance Conversion***”!



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18

We discussed “the good news and the bad news” about inheriting an IRA:

- The good news is inheriting a windfall...
- The bad news is taxes, taxes and more taxes.

As an IRA beneficiary, you must pay taxes on the entire account balance, just like you'd have to do for a Roth Conversion, but you can't convert those Inherited IRA distributions to a Roth IRA.

To get something similar, you might want to consider Life Insurance!



## Advantages Of Life Insurance



Let's briefly review the advantages of Life Insurance

## Look At The Life Insurance Benefits

- ✓ The client obtains additional life insurance death benefits to protect themselves and their loved ones
- ✓ After the Inherited IRA has been distributed and taxed,
  - the beneficiary protects the inheritance from future taxation on growth & distributions during their lifetime,
  - AND when their beneficiaries inherit the death benefit
- ✓ Client has significant flexibility to access the money, but doesn't have to (*there are no required distributions*)
- ✓ Advisor has offered a meaningful recommendation, and builds credibility through the "value added"
- ✓ Advisor generates meaningful revenue in exchange for their planning expertise



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20

Here are just a few of the significant benefits of using life insurance in this situation:

- ✓ The client obtains additional life insurance death benefits that protect themselves and their loved ones
- ✓ The client has the potential to protect their inherited IRA from all future taxation (after 10 years), during distribution to themselves **AND** to their beneficiaries
- ✓ The client has significant flexibility to access the money, but doesn't have to... there are no required distributions.
- ✓ The advisor is making a meaningful recommendation for the client, and builds credibility through the "value added" benefits of introducing the idea.
- ✓ And the advisor generates meaningful revenue in exchange for their planning expertise.



## Where Do We Go From Here?



So where do we go from here?

## Next Steps... Implementation

1. During portfolio reviews with clients between age 40 - 60, ask:
  - ***“Did your parents recently pass away, or do you expect them to pass away in the near future?”***
  - If “yes” ask: ***“Did (or will) you inherit an IRA from them?”***
  - Begin preparing for the opportunity!
2. Identify current clients in their 70’s and 80’s that have IRA assets that they’re leaving to their kids... begin this conversation.
  - Get introduced to their children and grandchildren



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22

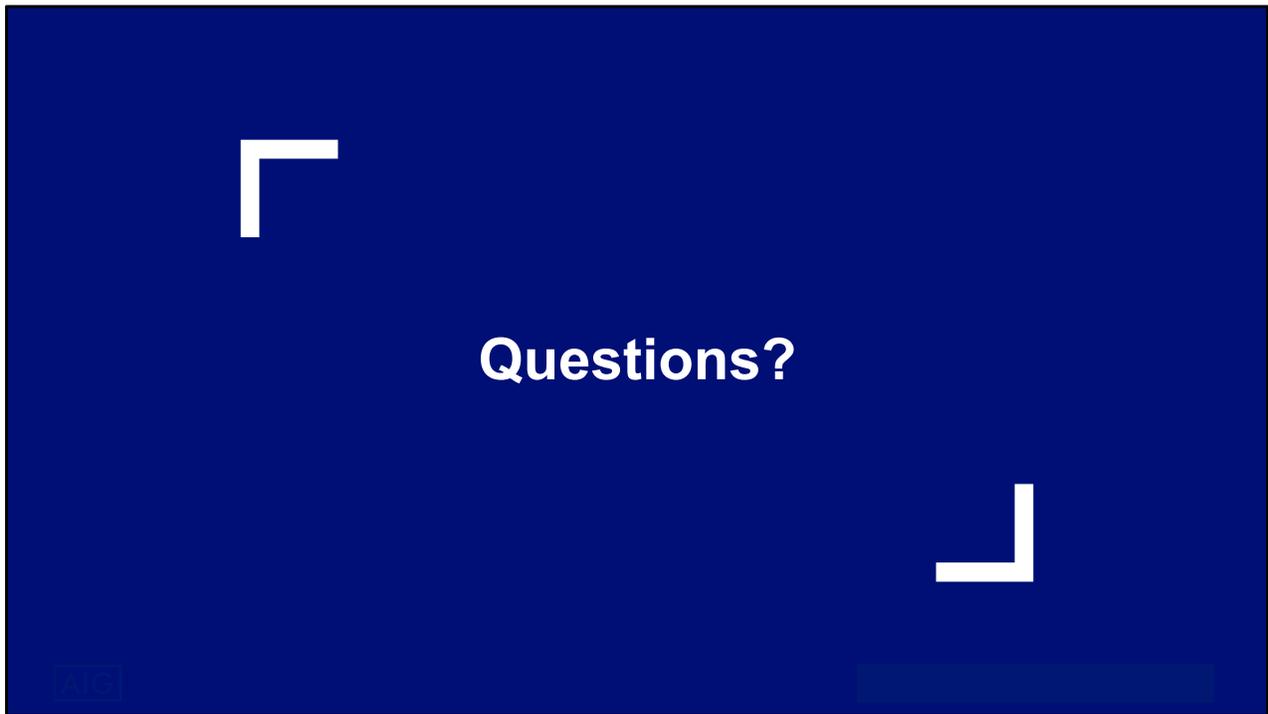
What should we do next?  
Let’s talk about implementation.

First, during portfolio reviews you have with clients between age 40 & 60, ask:  
***“Did your parents recently pass away, or do you expect them to pass away in the near future?”***

If the answer to that question is “YES,”, then ask: ***“Did you (or do you expect to) inherit an IRA from them?”***

Start the discussions even before the parents pass away to be prepared for the opportunity.

Second, identify current clients in their 70’s and 80’s that still have IRA assets that they’re likely leaving to their kids. Begin this conversation with them. They may want to put some wheels in motion sooner rather than later.



Does anyone have any questions they'd like to ask, or thoughts they'd like to express about today's content?

If so, reach out to us and let us know.



## You Inherited An IRA... Now What?



Thanks for joining us for today's discussion. I hope you learned a few things about ***The SECURE Act***, and some ideas you can discuss with your clients and their beneficiaries about alternative approaches that might help them reach their goals.

Here at AIG we'll continue to provide you with the products, the services and the people that have become the hallmark of AIG's reputation.

And I'd like to extend my thanks to all of you for everything you do to help your clients achieve and protect their lifetime of financial security.

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25

Please review these important notes about today's discussion. If you need extra time reading these notes, just press "pause," and then press "play" to resume.

We see the future in you.<sup>SM</sup> — 

Thanks for joining us, and have a fantastic day.