MANAGING YOUR FINANCES

Putting a Deferred Annuity in an IRA

IN THESE uncertain economic times, a retiree or someone nearing retirement might be looking to cushion a nest egg from the markets' blows. One way to do that is to buy an annuity.

But you need to think carefully before you buy a tax-deferred variable annuity for an IRA or within a 403(b) or a 401(k). When you hold an annuity in a retirement account, certain issues—regarding tax treatment, required minimum distributions and rollovers—can be tricky.

■ **Taxes.** If you're buying an annuity only for its tax deferral, there is little reason to hold it inside a traditional IRA, which already is tax-deferred. Benjamin Sullivan, a financial planner with Palisades Hudson Financial Group, in Scarsdale, N.Y., suggests maxing out contributions to your retirement accounts first. "You don't have to pay an insurance company excessive fees to get into these tax-advantaged accounts," Sullivan says.

Placing an annuity in an IRA makes sense if you really want lifetime guaranteed income and don't have enough money outside an IRA to buy an annuity. "Tax deferral shouldn't be the determining factor," says Brian Kunkel, national director of advanced planning and solutions for Prudential Annuities. "The investor receives tax deferral whether or not the annuity is purchased inside of an IRA."

■ **RMDs.** Taking required minimum distributions becomes more complex if you hold an annuity inside a tax-advantaged account. A key factor is whether the annuity contract has been "annuitized"—that is, turned into a lifetime stream of income payments. With a variable annuity, you invest in a portfolio of mutual funds, which grows tax-deferred for a number of years. When you annuitize the contract, the payouts will be based on the growth of the underlying investments.

A deferred annuity with a guaranteed benefit that has not been annuitized has a value that is used to calculate RMDs. With some annuities, mostly older contracts, an RMD could lower your guaranteed payout. That's because the insurer would recalculate the guaranteed payout based on the value of the account after the RMD is taken. With most annuities sold today, the RMDs would not affect the guarantee, says Kunkel. But you need to check the terms of the contract before buying.

Once you annuitize, the annuity itself no longer comes into play when determining an RMD. Jeff Levine, IRA technical consultant for Ed Slott and Co., in Rockville Centre, N.Y., says the guaranteed payouts satisfy the RMD requirement. You no longer need to calculate an RMD based on the account value on December 31 of the previous year. In the year after you annuitize, your payouts will cover your RMDs for the annuity portion of your IRA.

If you have non-annuity assets in your IRA, you will need to calculate the RMD separately for that portion. Essentially, you will end up with two streams of income from your IRA: the RMDs from your non-annuity assets and the payouts from your annuity. You will pay income tax at ordinary rates on all of that income.

Take special care if you have an annuity with riders, such as a guaranteed minimum withdrawal benefit. The extra value of the riders must be included when the RMD is calculated for a non-annuitized contract, says Levine.

■ **Rollovers.** Rolling a 401(k) or 403(b) into an IRA can be a problem if your employer-sponsored retirement plan includes an annuity. You likely would have to cash out the annuity first, says Scott Dauenhauer, a financial planner with Meridian Wealth Management, in Murrieta, Cal. You may also have to pay a surrender charge.

Think carefully before making this move. Many contracts "have guaranteed rates that you can't get now," says Dauenhauer. You will need to compare the benefits of keeping the annuity in the employer plan to the returns you may get in an IRA, where your investment options are unlimited. **K** —RACHEL L. SHEEDY