

The “Daily Plan-It”™

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Annuity “Rollover” Mistake Results in Taxation

Today’s *Daily Plan-It*™ addresses an important issue for all professionals who work with annuities.

A good annuity can make such a huge difference in a successful financial plan. We wanted to take this opportunity to alert you to an important ruling that it’s essential you become familiar with. IRS Revenue Ruling 2007-24 addresses an issue that could create liability for other professionals if they’re not paying attention to important—sometimes called “little”—details.

“Rollover” vs. 1035 Exchange

The facts of this ruling are interesting. In short, an annuity owner asked the IRS if he could rollover the proceeds from one annuity to another under IRC Section 1035. As most professionals know, Section 1035 allows you to do this as a tax-free exchange. In other words, there’s no tax recognition of the gain built up inside the annuity.

Endorsing a check

The owner had purchased a non-qualified annuity with an insurance company. He later wanted to purchase a new annuity with a different insurer. The company that provided the initial annuity refused to do the exchange. Instead, it distributed the annuity proceeds via a check to the owner. He then took the check, endorsed the back of it, and provided the proceeds via the endorsed check to the second company to purchase his new annuity. Note that he never deposited the check—he immediately endorsed it over to the second company.

Advice from the IRS

Realizing the dilemma, the annuity owner then requested the Revenue Ruling to seek guidance on whether this was a Section 1035 exchange, or whether the income generated on this transfer was taxable income.

Ouch...it’s taxable!

The IRS ruled that, because the owner took possession of the check (even though it was endorsed immediately over to the second company), the income was taxable as an annuity withdrawal under IRC Section 72(e).

Tough lessons learned

Section 1035 exchanges require strict adherence to the rules and regulations. If you want the benefit, you need to follow the rules. The owner could have had the annuity directly assigned to the new insurance company. This is a pretty standard process. Why this one went awry is unclear; but we all can learn from it. If you’d like more information, download the ruling at http://www.irs.ustreas.gov/irb/2007-21_irb/ar15.html.

We hope you found this article useful, and, as always, thank you for your referrals and support. We sincerely appreciate it.

At Sullivan & Schnittker, we create estate plans tailored to your clients’ specific needs and goals. Drawing on listening, counseling, consulting and legal expertise, we learn about your clients’ goals, aspirations, concerns and fears. We explore strengths and weaknesses in a comfortable and confidential environment.

That’s not all. Our comprehensive team planning approach includes you, your clients’ most trusted advisor, whom they rely upon for help and advice.

It all culminates in a well-designed and thoughtful plan, unique to your clients’ goals. Your clients achieve peace of mind and they will thank you for it. This results in deeper relationships, more business and happy clients. A genuine “win-win-win” situation.