Aggregate Annuity Rules

While the actual taxation of aggregate annuity polices varies by insurance company, the IRS rules are clear. Section 72 of the internal revenue code governs the income tax treatment of amounts received under an annuity contract. Amounts received under an annuity contract are includible in income except to the extent that they represent a return of the "investment in the contract," i.e., premiums or other consideration paid for the contract, minus the aggregate amount previously received under the contract that was excludable from gross income. The 1988 Act added the Section 72(e)(11) the aggregation rule, under which all deferred annuity contracts issued by the same insurance company to the same policyholder during any calendar year are treated as one annuity contract. This aggregation rule prevents the marketing of multiple deferred annuities, referred to as serial contracts, designed to avoid the income-out-first rules of Section 72(e).

More insurance companies are coming into compliance with this rule. However, their interpretation can vary greatly. Some companies will use a calendar year and some companies will use a 12-month period. Depending upon the policy if the account is owner driven or annuitant driven you can have multiple ownerships.

For example, using an owner driven policy; the husband owns one policy, the wife owns one policy and a family trust owns one policy. This would allow 3 policies that would not be affected by the aggregate rule.

Using the split annuity concept, some clients will choose a fixed and an index strategy annuity. Many strategies we have seen involve a 5-year SPIA and 2 deferred annuities, one to be annuitized after the 5th year and one to be annuitized after the 10th year.

If the client wants to use this strategy you could do the SPIA, and one deferred annuity with one company and the other deferred annuity should be written with a separate company.

This does not affect the purchase of an immediate annuity and a deferred annuity. It does affect multiple contracts issued if the client decides to annuitize one policy or take distribution from one policy all of the earnings are combined and the client is taxed on the aggregate.

For example, a client purchases 2 deferred polices for $100,000 each earning 4%. At the end of the first year they decide to withdraw 10% from one policy or $10,400 ($100,000 X 4% = $104,000 X 10% = $10,400). Instead of taxing just the $4,000 in earnings, the withdrawal is aggregated with the other policy, and the taxable portion is $8,000.