



Nonqualified Annuity Distribution Planning Reference Guide

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Target Client:

- Nonqualified assets of \$100,000 and above
- Qualified plan contributions already maximized

Key Characteristics:

- Recognizes longevity and catastrophic illness risks spouses face and wants assets beyond retirement funds for added protection
- Desires to extend the maximum tax-deferral potentially beyond their own death for their beneficiaries' advantage
- Plans to help provide for beneficiaries, which may also include the beneficiaries' beneficiaries

Nonqualified Annuity Advantages:

- Control afforded in the distribution of the nonqualified annuity
- Transfer of assets to subsequent generations can be done in a tax-efficient manner
- Encourages planning for the long term
- An important part of an estate plan
- Beneficiaries can extend tax-deferral benefits

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Nonqualified Annuity Distribution Planning

Nonqualified annuities offer unique opportunities for your clients by coupling tax-advantaged savings with insurance features. They also provide a means to assure income for their annuity beneficiaries guaranteed to last a lifetime.

Your clients with nonqualified annuities should be familiar with the options for distributing annuity benefits at the death of the annuitant. Rules established by Internal Revenue Code (IRC) Section 72(s) and Integrity contracts govern such distributions. There are no requirements that distributions from a nonqualified annuity be made during the lifetime of the annuity owner or annuitant, but distributions are required at the annuitant's or owner's death. These distribution requirements vary depending on whether death occurs before or after the annuity starting date.

Integrity offers you the ability to assist your clients in meeting their wealth accumulation, preservation and distribution objectives using the Nonqualified Extended Annuity Program form and the Annuitant Beneficiary Designation Form. Use of these forms to select distribution options described in this Reference Guide can protect beneficiaries from early taxation of annuity benefits and preserve nonqualified annuity tax-deferral features for as long as possible.

Contractual Provisions of Annuities Issued by Integrity

Typically, Integrity annuity contracts are annuitant-driven and pay a death benefit at the annuitant's death. The annuitant is the owner of the contract unless Integrity accepts another designated owner. During the annuitant's lifetime, all rights and privileges under the annuity contract may be exercised solely by the owner, including the election to apply the death benefit to any payout option offered by Integrity at the time the election is made.

An annuity is a long-term financial vehicle designed for retirement purposes. This guide discusses the tax advantages of certain nonqualified annuity distribution options. Note that a potential tax disadvantage of a nonqualified annuity is that all gain is taxed as ordinary income.

This Reference Guide has been prepared with descriptions that assume the contract owner and annuitant are the same person.

If the owner and annuitant are different individuals and the owner dies before the annuitant, Integrity allows for payment of the annuity surrender value to the owner's beneficiary in a lump sum, or under provisions described below in the sections titled "The Five-Year Rule of IRC Section 72(s)(1)(B)" and "The One-Year Rule of IRC Section 72(s)(2)". If the annuitant dies after the owner's death, the death benefit, less proportional reduction for distributed contract values, will be paid to the annuitant's beneficiary.

At the death of the annuitant, Integrity annuity contracts allow for payment of the annuity death benefit under certain options described in the Options for Distributing Nonqualified Annuity Values section below.

Note that Integrity annuity contracts do not allow the owner to restrict payment of the annuity surrender value at the death of the owner if the annuitant is living at the owner's death.

Options for Distributing Nonqualified Annuity Values

Owner's Death Before Annuity Starting Date

Distributions from a nonqualified annuity made to a nonspousal beneficiary before the annuity starting date and after the death of the annuity owner/annuitant are controlled by either the Five-Year Rule or the One-Year Rule of IRC Section 72(s).

The Five-Year Rule of IRC Section 72(s)(1)(B)

The Five-Year Rule is the basic rule for distribution of nonqualified annuity balances (with exceptions as noted below). It requires that the entire interest of an annuity contract be distributed within five years after the death of the owner/annuitant.

A benefit of the Five-Year Rule is that it allows the annuity to grow tax-deferred for up to five years after the death of the owner/annuitant. A drawback is that the annuity must be distributed and taxed to the beneficiary at some point during the five-year period.

The Five-Year Rule will apply if there is no designated beneficiary of the policy; if the designated beneficiary is not an individual (e.g. is a trust, estate or charity); or if distributions under the One-Year Rule described below do not begin within one year after the death of the owner/annuitant.



The One-Year Rule of IRC Section 72(s)(2)

The One-Year Rule is the exception to the Five-Year Rule. It allows nonqualified annuity distributions to be “stretched” over a period based on the life expectancy of a designated beneficiary.

Two methods can be used to satisfy the One-Year Rule. One requires that the annuity assets be distributed over the lifetime of the beneficiary based on his or her life expectancy. The other requires that the assets be annuitized. Both methods mandate that distributions begin no later than one year following the death of the annuity owner/annuitant. The distribution period for both methods must be based on the life expectancy of the beneficiary. For annuities with more than one beneficiary, the life of the beneficiary with the shortest life expectancy will determine the distribution period. If the annuity contract is divided into separate shares for each beneficiary, the age and life expectancy of each beneficiary can be used to determine that individual’s distribution period.

The 60-Day Rule

IRC Sec. 72(h) requires that selection under the One-Year Rule be made within 60 days after the annuity distribution became available. To assure compliance, the annuity carrier must be notified within 60 days of the date the annuity distribution became available of the beneficiary’s intent to take the annuity distribution in a form other than a lump sum. If this notification is not made on a timely basis, the beneficiary will be required to take the annuity distribution within five years of the death causing the distribution. The 60-day rule will be satisfied if the annuity owner records with the annuity carrier during his or her lifetime a beneficiary designation directing an annuitization of the contract or payment over the annuitant’s beneficiary’s life expectancy.

Spousal Beneficiary Exception of IRC Section 72(s)(3)

Neither the Five-Year Rule nor the One-Year Rule apply at the death of the owner/annuitant if the owner’s surviving spouse is the owner’s sole designated beneficiary, the annuitant’s sole designated beneficiary and no contingent annuitant is named. The surviving spouse may elect to be treated as the owner of the contract and continue the policy at the death of the owner/annuitant. When spousal continuation is elected, distributions from the contract are not required until the spouse’s death.

To receive the enhanced “spousal continuation benefit” under Integrity contracts, the owner and annuitant must be the same person, the spouse must be named as the owner’s sole beneficiary and the annuitant’s sole beneficiary, and no contingent annuitant and no joint owner should be named.

Death After Annuity Starting Date

Under the terms of IRC Sec. 72(s)(1)(A), if the owner/annuitant dies after the annuity starting date, the balance of the annuity value must be distributed as least as rapidly as under the distribution method in use before the death of the owner/annuitant.

Stretching Distributions from a Nonqualified Annuity

The One-Year Rule of IRC Sec. 72(s)(2) provides flexibility. It allows distributions from a nonqualified annuity to be made over the designated beneficiary's life expectancy, or over any period shorter than the beneficiary's life expectancy. If desired, the owner of an Integrity annuity contract can restrict distribution at the annuitant's death of some or all of the annuity's value according to terms established by the owner. This restriction is accomplished by completing and recording with Integrity the Annuitant Beneficiary Designation Form illustrated at the end of this guide. Alternatively, the owner can allow the beneficiary to determine the manner and frequency of distributions.

Two Methods Available for Stretching Distributions

Required annuity distributions can be made over the life expectancy of the beneficiary using either the life expectancy method or the annuitization method. Under either option, distributions must begin within one year of the death of the owner/annuitant. IRC Sec. 72(s)(2) also allows distributions over a period not extending beyond the beneficiary's life expectancy. To pay out a new business annuity benefit over a period shorter than the beneficiary's life expectancy, Integrity requires the use of the annuitization method.

Distributions Over the Beneficiary's Life Expectancy

To stretch distributions over the life expectancy of the beneficiary, divide the annuity account balance by the life expectancy of the beneficiary. Life expectancy is determined by the single life table of Treasury Regulation 1.401 (a)(9)-9. For example, if the beneficiary is age 35, the annuity account balance would be divided by 48.5 to determine the amount to be distributed in year one. The amount to be distributed in year two would be determined by dividing the account balance by 47.5. Each successive year's divisor is 1 less than the prior year's divisor. The basis of the contract is spread in equal amounts over the beneficiary's life expectancy.

The first distribution must be made no later than one year after the death of the owner/annuitant. The beneficiary may elect to take distributions more rapidly or in a larger amount than determined using this stretch method. Alternatively, the owner may restrict the beneficiary's right to take distributions more rapidly or in larger amounts than determined using the life expectancy distribution method.



Annuitized Distributions

Distributions can be stretched by annuitizing the contract assets. Annuitization must begin no later than one year after the death of the owner/annuitant. Many options are available for an annuitized distribution of the value of the annuity account. They include a life annuity, a life annuity with a period certain guarantee or distribution over a designated period. If the Internal Revenue Code or Treasury Regulations require that distributions be made over a shorter period than the term of years selected, the term of years will be reduced to the term permitted.

Beneficiary Selection

To stretch nonqualified annuity distributions at the death of the annuity owner/annuitant as long as possible, the owner must name an individual as beneficiary. If an entity such as a trust, partnership or corporation is the beneficiary and the owner/annuitant dies before the annuity starting date, Treasury Regulations require the annuity account balance to be distributed within five years in compliance with the Five-Year Rule.

Multiple Beneficiaries

An annuity can have multiple beneficiaries. The beneficiary designation determines how the annuity account value is split among them. Each annuitant's beneficiary may elect to stretch the distribution of his or her respective account value based on that person's own life expectancy. To accomplish this, the annuity contract must be divided into separate shares for each beneficiary.

Restricted Beneficiaries

The owner of an Integrity annuity contract can restrict the method of distribution of contract values upon the annuitant's death. Distribution options include a life annuity, life annuity with 10 or 20 years guaranteed, a designated period of five to 20 years or a systematic withdrawal over the beneficiary's lifetime or a period of years not exceeding the beneficiary's life expectancy. The Integrity Annuitant Beneficiary Designation Form allows customization of the distribution period for each annuitant's beneficiary. For example, one beneficiary may have no restriction on distributions. Another may be limited to distributions determined by the contract owner.

Successor Beneficiaries

An Integrity annuity beneficiary can select a successor annuitant's beneficiary to receive annuity distributions if the primary annuitant's beneficiary dies while receiving distributions under the terms of the Annuitant Beneficiary Designation Form. For example, assume that grandfather as owner and annuitant has named his daughter as annuitant's beneficiary. Under the terms of the Annuitant Beneficiary Designation Form, the daughter will receive distributions over her life expectancy at the death of the grandfather. The daughter has named the owner/annuitant's granddaughter as successor beneficiary. The granddaughter, rather than the daughter's estate, will receive distributions of any remaining annuity interest at the death of the daughter. Annuity distributions to the granddaughter will be made based on the daughter's life expectancy.

Use of the Nonqualified Extended Annuity Program form or the Annuitant Beneficiary Designation Form takes advantage of the One-Year Rule of IRC Sec. 72(s)(2) to protect annuity assets for the beneficiary by:

- Minimizing required distributions
- Providing time for potential additional tax-deferred growth of annuity assets
- Deferring income taxation of annuity assets until distribution to the beneficiary
- Providing an income stream for the lifetime of the beneficiary

Case in Point – Distribution Options

Assume that Mary purchased a nonqualified annuity 20 years ago with an initial investment of \$250,000 and made no withdrawals over a 20-year period. Mary is the owner and annuitant, and named her daughter, Joan, age 35, as the owner's and annuitant's beneficiary. At Mary's death, Joan can select one of four methods for taking distribution of her mother's annuity value.

Mary's investment in her nonqualified annuity	\$250,000
Net average annual return	8%
Current value of Mary's annuity:	\$1,165,239

This example is hypothetical for illustrative purposes only. It is not intended to predict or project any actual investment result. It is based on a \$250,000 nonqualified (after-tax) initial investment, accumulated for 20 years at a constant growth rate of 8%. Tax-deferred means contributions are not currently taxed, but earnings are subject to ordinary income tax at withdrawal. Withdrawals may be subject to a 10% IRS penalty tax if taken prior to age 59½. Individual tax situations vary. Consult an attorney or accountant for specific advice. Fees, charges and expenses are not included and if included would lower performance.

These examples assume that Mary's estate is not subject to federal or state estate tax.



Lump-Sum Distribution

Joan could elect to take a distribution of Mary's entire annuity value at the time of Mary's death. We will assume that Joan has a combined state and federal income tax rate of 35%.

Annuity value:	\$1,165,239	(\$250,000 initial investment earning a net 8% return)
Taxable amount:	\$915,239	(\$1,165,239-\$250,000 initial investment)
Taxes owed:	\$320,334	(\$915,239 x 35%)
Joan's net after tax benefit:	\$844,905	

Distribution at End of the Five-Year Period

Joan could elect to allow the assets in the annuity to accumulate tax-deferred for five years and then take a lump-sum distribution of the annuity value.

Current value:	\$1,165,239	
Five-year value:	\$1,712,118	(net 8% average return)
Taxable amount:	\$1,462,118	(\$1,712,118 - \$250,000 initial investment)
Taxes owed:	\$511,741	(\$1,462,118 x 35%)
Net after tax benefit:	\$1,200,377	

Nonqualified Stretch Annuity

Joan could select distribution of the annuity over her life expectancy under provisions of the One-Year Rule of IRC Sec 72(s)(2). This distribution method would allow tax-deferred growth of the annuity as it is distributed over Joan's 48.5-year life expectancy.

As illustrated below, Joan would receive a cumulative after-tax benefit of more than \$8.6 million by electing to stretch annuity distributions over her lifetime. If the entire annuity balance is not distributed while Joan is alive, remaining annuity distributions could be made to her named successor beneficiary based on Joan's remaining life expectancy.

Current value: \$1,165,239 (beginning of year)

Year	Contract Value	Annual Distribution	Net Distribution (After Tax)	Net Cumulative Benefit
1	\$1,258,458	\$25,948	\$18,670	\$18,670
2	\$1,331,111	\$28,023	\$20,019	\$38,689
3	\$1,407,335	\$30,265	\$21,477	\$60,166
4	\$1,487,235	\$32,686	\$23,050	\$83,216
5	\$1,570,913	\$35,301	\$24,750	\$107,966
10	\$2,048,839	\$51,869	\$35,519	\$262,371
20	\$3,303,470	\$111,982	\$74,592	\$807,901
30	\$4,714,336	\$241,761	\$158,949	\$1,964,751
40	\$4,958,463	\$521,943	\$341,067	\$4,441,395
48	\$1,449,121	\$966,081	\$629,757	\$8,353,134
49	\$521,684	\$521,684	\$339,996	\$8,693,131

Note: contract values are end-of-year values before distribution; distributions are taken annually at the end of the year.

Restriction of Annuitant's Beneficiary

Instead of allowing Joan her choice of annuity distribution methods, Mary could complete an Annuitant Beneficiary Designation Form to restrict Joan's distributions of Mary's annuity values to the method selected by Mary.


Annuitization

Joan could elect to annuitize the balance of Mary's annuity value. Joan could select among a number of income options. The amount of Joan's distribution would depend on the type of annuitization plan selected.



Nonqualified Extended Annuity Program Form — A Closer Look

For new business, this form is included with the application and 1035 exchange information. The form is to be completed with information about the deceased, the annuity beneficiary stretching the annuity payment over his or her life expectancy, and the beneficiary account established for the beneficiary with the old carrier.

	Integrity Life Insurance Company 400 Broadway Cincinnati, Ohio 45202-3341
Nonqualified Extended Annuity Program	
<p>The Nonqualified Stretch Program is offered by Integrity Life Insurance Company (Integrity). The program is a death benefit distribution program that allows payment of the death benefit over the beneficiary's life expectancy. An annual payment amount is required to be withdrawn each year. You may withdraw the payment amount at a payment frequency you choose. Each year Integrity will calculate your payment and distribute it according to your payment selections. Please note that Integrity will not accept non-qualified extended contracts from another company where the beneficiary has elected the 5 year deferral option. This program is available only to living beneficiaries. This program is not a spousal continuation.</p>	
SECTION 1: DECEDENT/BENEFICIARY INFORMATION	
Decedent Information	
Name	Date of Birth
Social Security Number	Date of Death
Beneficiary Information	
Name	Date of Birth
Social Security Number	Relationship to the Deceased
Address	City, State, Zip
SECTION 2: TRANSFERS IN	
Please indicate the date that a separate beneficiary account was established for you. (mm/dd/yy) _____	
Did you make your election to received stretch payments of the death benefit within 60 days from the time the benefit was payable to you?	
<input type="checkbox"/> Yes <input type="checkbox"/> No	
Did you begin receiving payments of the death benefit prior to requesting this transfer to Integrity?	
<input type="checkbox"/> Yes <input type="checkbox"/> No	
If yes, please provide the date of your first payment. (mm/dd/yy) _____	
Have you received your payment for the current calendar year?	
<input type="checkbox"/> Yes <input type="checkbox"/> No	
Please provide a copy of your account statement that includes the most recent December 31 value.	
SECTION 3: PAYMENT FREQUENCY	
Integrity offers monthly, quarterly, semi-annual or annual payments. Payments can be made on any day of the month except the 29th, 30th or 31st. Payments will continue on the same day of the month at the interval specified below. Payments will be made pro rata from your investment options. Minimum dollar amounts may apply.	
Please select the frequency of your payment:	
<input type="checkbox"/> Monthly <input type="checkbox"/> Quarterly <input type="checkbox"/> Semi-Annually <input type="checkbox"/> Annually	
Payments will continue as elected until the earlier of (1) the date that the value in the contract would not support an additional withdrawal; (2) the date Integrity received written instructions from you to change frequency of the withdrawals; or (3) the date Integrity discontinues this withdrawal option.	
Notice of Withholding of Income Tax on Withdrawals or Distributions	
Federal tax law requires Integrity to withhold federal income tax at a rate of 10% from the taxable portion of any distribution or withdrawal, unless you elect NOT to have withholding apply.	
Certain states may also require income tax withholding from the taxable portion of your distribution. In most cases, your federal withholding election would also apply to any state withholding election, although the rate of tax may vary among states. Note that Integrity will perform mandatory withholding if required by state law.	
IL-77-0042-0802	

Taking a look at our example, if Mary Jones is the deceased owner/annuitant who has named Joan Smith as her beneficiary, the new business application would be completed as follows:

Annuitant: Mary Jones, deceased

Annuitant's date of birth on application: Beneficiary's date of birth

Owner: Joan Smith

Owner would name Owner's beneficiary and Annuitant's beneficiary, who would receive the balance of any distributions at the death of Joan Smith. The distributions to Joan Smith's beneficiary would continue to be stretched over Joan's previously established actuarial life expectancy, or the beneficiary could request that distributions be made more rapidly.

Annuitant Beneficiary Designation Form — A Closer Look

Integrity Life Insurance Company
Cincinnati, Ohio

Annuitant Beneficiary Designation Form

This program only applies to the death benefit paid upon the Annuitant's death to the person(s) named as the Annuitant's beneficiary(ies). It does not apply to the payment of proceeds payable upon Owner's death to the Owner's beneficiary.

CONTRACT INFORMATION

Must be completed for all requests.

Contract Owner	Contract Number
Social Security Number	Phone Number

BENEFICIARY INFORMATION For additional beneficiary designations make copies of both pages, or contact Integrity at 800.325.8583. Only one signature page is required.

Primary Beneficiary Contingent Beneficiary Beneficiary # ____ of ____

Name	Relationship	Social Security Number	Date of Birth
Address			Allocation

BENEFICIARY RESTRICTION INFORMATION

No Restriction (default)

I (we) direct that this Beneficiary may elect the form of death benefit payment.

Full Restriction - I (we) direct that the total death benefit payable to this Beneficiary be applied to the annuity option elected below.

Life Annuity

Life Annuity with ____ years guaranteed (10, 20)

Designated period of ____ years (5 to 20)

Systematic Withdrawal (Check one and choose number of years if applicable)

Over Beneficiary's life expectancy

Over ____ years*

* If the Internal Revenue Code and Regulations require that distribution must be made over a shorter period than the term of years selected, the term of years will be reduced to the term permitted.

Partial Restriction - I (we) direct that part of the death benefit may, at the election of the Beneficiary, be paid in a lump sum as provided in this Partial Restriction section and the remainder be applied to the annuity option elected above.

_____% This Beneficiary may receive up to this percentage of the death benefit in a lump sum payment. The remainder is to be applied to the annuity option elected above.

\$ ____ This Beneficiary may receive up to this dollar amount in a lump sum payment. The remainder is to be applied to the annuity option elected above. If the total death benefit is less than this amount, the total death benefit will be paid in a lump sum.

Monthly payouts to Beneficiary(ies) must be a minimum of \$100.00 or a lump sum distribution will be made.

DISBURSEMENT FREQUENCY

Frequency (check one)

Monthly (default) Quarterly Semi-Annually Annually

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Contract Owner can elect to have no restriction on payment of assets for a particular beneficiary.

Contract Owner can elect a full or partial restriction of payment of assets.



Notes





Payment of benefits under the annuity contract is the obligation of, and is guaranteed by, the insurance company issuing the annuity. Guarantees are based on the claims-paying ability of the insurer. Integrity annuity products are backed by the full financial strength of Integrity Life Insurance Company, Cincinnati, Ohio, a member of Western & Southern Financial Group®

Earnings and pre-tax premium payments are subject to income tax at withdrawal. Withdrawals prior to age 59½ are generally subject to a 10% IRS penalty tax.

Integrity does not offer tax advice. For specific tax information, consult your attorney or accountant. Product and feature availability, as well as benefit provisions, vary by state. Contact your financial professional for product details and limitations.

No bank guarantee	Not a deposit	May lose value
Not FDIC/NCUA insured	Not insured by any federal government agency	

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