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## IRS Makes Annuities RIA-Friendlier

By Kerry Pechter    Thu, Aug 15, 2019

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*'The fees [the annuity issuer] deducts from the contract's cash value and remits to the advisor will not be treated as an "amount received" by the owner of the contract,' the IRS told several life insurers in separate Private Letter Rulings.*

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Fee-based financial advisers now have one less reason not to recommend annuities to clients, thanks to the private letter rulings (PLR) that at least four life insurers—Nationwide, Lincoln Financial, Prudential and Great American—recently received from the Internal Revenue Service.

The company-specific rulings, long-sought by annuity issuers, allow the owners of non-qualified annuity contracts to direct the issuers of their deferred annuities to pay advisers a fee (up to 1.5% per year of the contract value) directly from the contract assets to the adviser without generating a tax bill for the client on the amount distributed.

Over the past decade, tens of thousands of agents, brokers and advisers have abandoned the commission-paid business model, or have left the big wirehouses to strike out on their own as investment adviser representatives (IARs) of registered investment advisers (RIAs). The “RIA market” refers to intermediaries who may wear different hats at different times when handling different products. Annuity issuers want to be ready for a variety of business models.



Maringer

The RIA market is far from monolithic. “We look at the fee-based market as three camps,” said Joe Maringer, national sales vice president for Great American. “You have the registered reps or insurance agents who have recently moved to the advice side but are familiar with annuities. The second camp includes dually registered advisers at independent broker-dealers (IBDs) like Raymond James, Commonwealth or LPL. It’s been reported that,

since 2017, more than 50% of IBD revenue comes from asset-based fees.

“Last but not least, you have the independent wealth management groups like Dynasty, Hightower, or Focus Financial that serve advisers who have broken away from wirehouses to hang out their own shingle,” he told *RIJ*. “We can bring in a fee-based index annuity and show them a better risk-profile, higher-yielding alternative to fixed income investments [i.e., bonds]. They are the longest reach for us because they haven’t had much exposure to insurance products. But they manage trillions of dollars. There’s also a fourth camp at super-regional banks, but bringing insurance into the advisory business is evolving more slowly there.”

It’s not clear yet how many other life insurers have asked or will ask the IRS for the same dispensation, or how many have already received it. The ruling removes what life insurers say was one reason why so many fee-based advisers don’t recommend annuities.

Here’s the essence of Nationwide’s PLR: “The fees [that the annuity issuer] deducts from the contract’s cash value and remits to the advisor will not be treated as an ‘amount received’ by the owner of the contract.” The distribution is recognized as distinct from an annuity payment or a random distribution.

Annuities in IRAs (“qualified annuities”) already enjoyed this tax treatment. “Historically, you had a split where, in the qualified annuity world, the IRS took the position that advisory fees were part of the retirement account and could come out tax-free,” said Craig Hawley, Nationwide Advisory Services, which requested and received the PLR.



Hawley

“But in the non-qualified annuity world, the IRS regarded taking out fees the same as if you were taking money out of the annuity to buy a car. That created tremendous friction for a customer receiving advice on a non-qualified annuity,” he added. Now the same rules on

distributions of fees apply to qualified and non-qualified annuities.

Nationwide serves about 6,500 RIAs; it gained about 4,000 of those customers in 2017 when it bought Jefferson National, which built a \$4.7 billion business selling low-cost, no frills variable annuities to RIA clients for use as tax deferral vehicles.

The PLR allows advisors to deduct up to 1.5% per year of the value of the annuity contract per year. It stipulates that advisors may use the annuity as a source of only those fees related to managing the annuity itself. It didn't want to create a loophole by which advisors could take all of their annual fee from the annuity tax-free.

Lincoln Financial Group received the same PLR, and released the following statement: "Lincoln is pleased with the favorable decision from the IRS and believes this new ruling will make it easier for investment advisors to incorporate non-qualified annuity solutions as part of their planning strategies."

A press release from Great American Life this week said it "was a key player in a coalition of insurance carriers that rallied for the change. Freeman Durham, Divisional vice president and senior counsel, Great American Insurance Group-Annuities, [said], 'We have been working with the IRS and other companies to achieve this change since 2017.'"

Obstacle by obstacle, life insurers are trying to remove the barriers that can discourage fee-based advisors from recommending annuities. Those obstacles may be philosophical, regulatory, legal, technical, and/or compensation-related. They augment clients' own reservations about annuities—mainly about their illiquidity.

Many fee-based advisors don't sell any commissioned products, so life insurers have built no-commission products. Since such advisors prefer using one Internet platform for all their chores, life insurers have embedded annuities into platform technology. Since fee-based advisors don't necessarily have insurance licenses, platforms make agents available to help close annuity purchases.

One of the remaining problems involved taxation of advisor compensation on non-qualified annuity contracts. If the advisory fee came out of contract and the owner of the contract received a Form 1099 from the IRS the following January for a taxable distribution, the owner might call the advisor for an explanation and instructions on dealing with it.

"As we were growing our advisory business, that was what we heard from investment advisor representatives," said Hawley. "They told us it was hard to adopt the product

because there was so much friction to getting paid.”

The life insurers have requested this dispensation from the IRS before, but without success. The Trump administration’s 2017 tax reform bill made the problem a bit worse by disqualifying advisory fees as itemized deductions from taxable income. “While it is fair to say the most recent tax reforms likely caused the friction to increase, this friction existed far before these reforms,” Hawley told *RIJ*.

But, despite the tax bill, the Trump administration turned out to be more receptive to the annuity industry’s case than the Obama administration had been.

“We have periodically gone to the IRS, and made the argument that there’s a retirement crisis and that we should incent the advisors [to use annuities],” Hawley added. “The IRS recently became more open to it.”

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