Insurance and Annuities

DEFERRED ANNUITIES

Presented for

Valued Client

Presented by

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DEFERRED ANNUITIES

The Concept…

- An annuity contract dictates that the insuring company will make regular payments for a specified time period, or for the life of the person receiving the income (the annuitant), in return for receiving one or more premiums from the person who purchases the annuity (contract owner). The annuitant may or may not be the contract owner.
- Annuitized payouts and all other guarantees are subject to the claims-paying ability of the issuing insurance company.
- Consumers purchase annuities for different reasons. Some want to take payments over a fixed period or for life. Others want to use the annuity to accumulate money for retirement, taking loans or withdrawals if they need current distributions.
- The annuities described below are called “fixed” annuities because they’re credited with a specified, fixed rate of interest. Some payout features are also fixed.

The Variations…

- An **immediate annuity** is purchased with a single premium and begins to make annuity payments immediately.
- A **deferred annuity** is purchased with either a single premium or a series of periodic premiums and begins making payments at some time in the future.
- A **single-premium deferred annuity** calls for the owner to fund the annuity with a single payment, the amount of which depends on the future income desired. This type of annuity is often purchased by an individual who has received or accumulated a large sum of money, such as an inheritance, a life insurance death benefit, a maturing bank certificate of deposit or a retirement plan distribution.
- A **flexible-premium deferred annuity**, on the other hand, lets the owner make smaller periodic payments over the life of the annuity until income payments begin. The owner may increase or decrease the premium payment as circumstances change (within limits established by the insurer). Of course, if the owner desires a specific future income amount, he or she must pay attention to the premium required to purchase that future income.

The Procedure…

- The insurance company deposits annuity premiums into its general account and pays interest at declared rates.

- The company may guarantee a current rate for a certain period, after which it is adjusted based on the interest rate environment. All guarantees are based on the claims-paying ability of the insurance company.
- Typically, a guaranteed minimum interest rate is specified, and will apply if current rates fall.
- The interest is left in the annuity to accumulate along with the premium payments.
- The advantage of the single-premium deferred annuity is that the money begins to earn interest immediately, which provides the potential for increased accumulation.
- Assuming the same dollar amounts are contributed to both, the accumulated value grows more gradually in the flexible-premium annuity as smaller, individual premiums are added over time.

The Tax Picture…

- Taxes are deferred on earnings during the accumulation period as long as the owner does not withdraw funds. This applies to both single-premium and flexible-premium deferred annuities.
- Nonqualified annuity payments are taxed under the IRC Section 72 annuity rules, which permit the tax-free recovery of basis over life expectancy. The balance of each payment is taxed as ordinary income.
- If the owner makes a partial or complete withdrawal before reaching age 59½, the IRS adds a 10% tax penalty to the taxable portion of the withdrawal, unless certain exceptions apply.
- No tax penalty is assessed if the owner dies or becomes disabled, or if the withdrawal is part of a series of substantially equal periodic payments usually made for the owner's life or life expectancy, or for the joint lives or life expectancies of the owner and a beneficiary.

The Payout…

- An annuity is commonly used to accumulate retirement funds, and should be considered a long-term plan. Insurers often assess a surrender charge if early withdrawals are made.
- When the annuitant begins receiving annuity payments, a number of settlement options are available:
  - **A straight-life (or life-only) annuity.** This option has the advantage of providing the maximum periodic payout. Payments end at the annuitant's death.

- **A joint-and-last-survivor annuity.** Payments are made until the death of the last annuitant. In some cases, a reduced payment—often two-thirds or one-half—is made when the first annuitant dies.
- **A period-certain annuity.** Income will be paid only for a specified period of time. The amount of each payment is determined by the length of the period, the interest rate, and the amount available in the annuity at the beginning of the payout.
- **An amount-certain annuity.** A specified amount will be paid regularly. The length of time it will be paid depends on how much is available in the annuity at the start, the interest rate, and the amount of each payment.
- **A refund annuity.** If the annuitant dies before receiving the full payout, the insurer will provide either continued income or a lump-sum settlement to a named beneficiary.
- **A death benefit.** Most annuities pay a death benefit to a designated beneficiary if the annuitant dies before annuity payments begin.

The Bottom Line…

Annuity products clearly offer a number of choices in terms of how funds accumulate, how they grow, and how they're paid out. Consumers should carefully consider their own personal circumstances and desires to come up with the right match.

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SUMMARY

What Is a Deferred Annuity?

An annuity is a contract under which an insurance company agrees to pay income to an individual in return for one large premium payment or a series of smaller payments.

Consumers purchase annuities with different strategies in mind. Some want to take payments over a fixed period or for their lifetime. Others want to accumulate money for retirement and then take loans or withdrawals if they need current distributions.

A deferred annuity delays the payout until some time in the future—often, retirement.

What Types of Deferred Annuities Are Available?

There are two broad types of deferred annuities. A single-premium deferred annuity is funded by a large lump-sum premium payment. A flexible-premium deferred annuity is funded by a series of smaller, periodic premium payments.

How Do Deferred Annuities Work?

The insurance company deposits net premiums into its general account, where the money earns current interest rates (or more, when a larger guaranteed rate is specified in the contract). Interest is left in the annuity and is not taxed until funds are withdrawn.

The insurance company may assess surrender charges if the owner withdraws funds early. In practice, some charges may be waived for partial withdrawals made within limits specified in the contract.

However, if the annuity owner is younger than age 59½, a 10% federal tax penalty is imposed on the taxable part of the withdrawal unless certain exceptions apply (for example, the owner's death or disability).

How Is Income Paid?

The annuity owner can select from numerous settlement options in determining how the payout will be made.

A **straight-life annuity** stops making payments when the annuitant dies, regardless of how much of the annuity still remains in the account.

A **joint-and-last-survivor annuity** makes payments until the last named annuitant dies.

With a **period-certain** or **amount-certain annuity**, income is paid for a specified period or in a specified amount until funds are used up.

A **refund annuity** continues making payments to a named beneficiary if the annuitant dies before recovering the entire amount.

What Are the Benefits?

Annuities provide a way to accumulate retirement income that is not taxed until funds are withdrawn. In addition, annuities offer a wide variety of distribution options.

How Are Distributions Taxed?

Distributions of earnings are taxed at the recipient's ordinary income tax rates. Distributions taken prior to age 59½ may be subject to a 10% federal tax penalty unless certain exceptions apply.

Clearly, there are many choices when selecting an annuity product to suit personal needs and circumstances. In deciding the right match for a particular situation, it's important to consider favorable taxation during the accumulation period and how funds are taxed and distributed during retirement.

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