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Annuity Maximization Strategies

First the good news: Demand for annuities has spiked in recent years as consumers begin to recognize the value of this safe, tax-deferred savings option.

Now the bad news: Most of those people who are buying annuities don't fully understand the tax disadvantages of having money in an annuity that will eventually be passed on as a wealth transfer case.

An annuity, with its ability to grow money tax-deferred, is an excellent retirement income vehicle, but it is usually a poor vehicle for wealth transfer—or at least it's not the best vehicle—because when the policyholder dies their annuity will be subject to a variety of taxes. In fact, depending on the size of the policyholder's estate, funds in their annuity could be subject to both estate and income taxes, substantially reducing the legacy they leave their loved ones.

So, if you find yourself with a client who has a deferred annuity that has been set aside for an inheritance, you may be able to help them make the most of those dollars by using the Annuity Maximization strategies below.

Selling an Annuity Maximization Case can be as simple as asking a single question:

Who Would You Rather Leave Your Nest Egg To?

OR

Basically, Annuity Maximization is a fancy term for leveraging the assets from a deferred annuity to fund an Irrevocable Life Insurance Trust (ILIT). The ILIT then purchases permanent life insurance that will pass to policyholder's heirs tax free. There are two widely accepted strategies for accomplishing this:

Strategy No. 1: Exchange the client's deferred annuity for a Single-Premium Immediate Annuity (SPIA) and use the resulting income stream to pay for permanent life insurance in an ILIT.
Let's look at the example of John, who is 65 years old and has built an estate worth $4.5 million. He has $1 million in an annuity that he plans on leaving to his children. Let's look at two scenarios: One where he leaves the money in the annuity, and another where he uses Annuity Maximization Strategy No. 1 to leverage his annuity to pay for a permanent life insurance policy.

Planning Assumptions:
65-year-old male (preferred non-smoker)
Current Estate: $4.5 million
Estate Tax Rate: 45%
Federal Income Tax Rate: 35%
Beneficiary's Federal Income Tax Rate: 35%
Life insurance policy owned by ILIT

Scenario 1: Maintain the Deferred Annuity

John continues to defer the annuity and it passes to his heirs 10 years later when he dies.

Current value of annuity	**$1,000,000**
Value in 10 years	**$1,480,244**
Assumed growth rate	**4%**
Estate Taxes owed	**$666,110**
Income Taxes due	**$168,085**
Net to the beneficiary	**$646,049**
Percentage lost to taxes	**56%**

Scenario 2: Annuity Maximization Strategy No. 1

John exchanges his deferred annuity for a SPIA from North American (NACOLAH). He uses the SPIA to fund a NACOLAH Custom Guarantee Universal Life insurance policy.

See Policy Illustration

Current value of annuity	**$1,000,000**
Annual Withdrawals from annuity*	**$123,456**
Annual life insurance premiums (10 years)	**$91,344**
Custom Guarantee UL Death Benefit	**$2,647,296**
Net to the beneficiary	**$2,647,296**

***annuity depleted after 10th year.**

So, with a $1 million SPIA from NACOLAH, John could take $10,288 a month for 10 years to fund the Custom Guarantee life insurance policy we illustrated for, allowing his heirs to receive $2,647,296 in death benefit—as opposed to the $646,049 they would receive without using Annuity Maximization.

Strategy No. 2: Take penalty-free withdrawals from the existing deferred annuity and use the proceeds to pay for a permanent life insurance policy in an ILIT.

This example, too, will allow John to purchase the Custom Guarantee life insurance policy though perhaps with a smaller death benefit. The SPIA approach generally creates a larger guaranteed income stream, which could mean a larger potential death benefit the policyholder's heirs or more money left over after paying premiums. However, once a deferred annuity is converted to a SPIA, the principal is gone and is not available in case of an emergency. That is one argument for keeping the deferred annuity and taking withdrawals. However, the income stream in this scenario is not guaranteed.

So it really the decision whether to go with Strategy No. 1 or Strategy No. 2 depends on what is most important to your client: having the larger, guaranteed income stream, or access to more funds in case of an emergency (unless your client is under age 59½, in which case they shouldn't take withdrawals on a deferred annuity because they could be subject to a 10% federal tax penalty).

Looking at the example above, it's difficult to ignore the value of Annuity Maximization as a strategy to help your clients make the most of their annuity dollars. For more information on Annuity Maximization as a sales concept call an SMS Marketer at 1-877-645-4939.