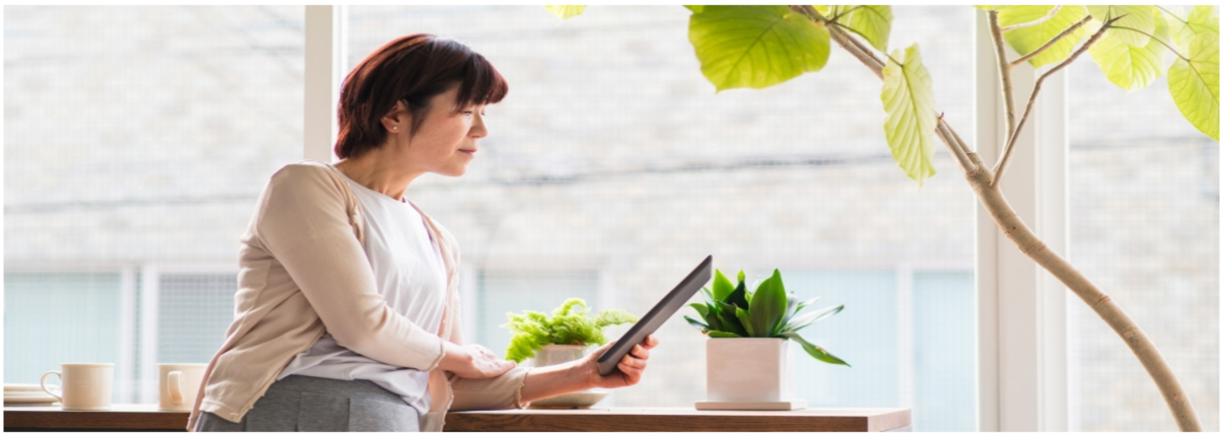
The Law Offices of KIDWELL & KENT NEWSLETTER

Annuities and Retirement Planning



You may have heard that IRAs and employer-sponsored plans (e.g., 401(k)s) are the best ways to invest for retirement. That's true for many people, but what if you've maxed out your contributions to those accounts and want to save more? An annuity may be a good investment to look into.

Get the lay of the land

An annuity is a tax-deferred insurance contract. The details on how it works vary, but here's the general idea. You invest your money (either a lump sum or a series of contributions) with a life insurance company that sells annuities (the annuity issuer). The period when you are funding the annuity is known as the accumulation phase. In exchange for your investment, the annuity issuer promises to make payments to you or a named beneficiary at some point in the future. The period when you are receiving payments from the annuity is known as the distribution phase. Chances are, you'll start receiving payments after you retire. Annuities may be subject to certain charges and expenses, including mortality charges, surrender charges, administrative fees, and other charges.

Understand your payout options

Understanding your annuity payout options is very important. Keep in mind that payments are based on the claims-paying ability of the issuer. You want to be sure that the payments you receive will meet your income needs during retirement. Here are some of the most common payout options:

- You surrender the annuity and receive a lump-sum payment of all of the money you have accumulated.
- You receive payments from the annuity over a specific number of years, typically between 5 and 20. If you die before this "period certain" is up, your beneficiary will receive the remaining payments.
- You receive payments from the annuity for your entire lifetime. You can't outlive the payments (no matter how long you live), but there will typically be no survivor payments after you die.
- You combine a lifetime annuity with a period certain annuity. This means that you receive payments for the longer of your lifetime or the time period chosen. Again, if you die before the period certain is up, your beneficiary will receive the remaining payments.

- You elect a joint and survivor annuity so that payments last for the combined life of you and another person, usually your spouse. When one of you dies, the survivor receives payments for the rest of his or her life.

When you surrender the annuity for a lump sum, your tax bill on the investment earnings will be due all in one year. The other options on this list provide you with a guaranteed stream of income (subject to the claims-paying ability of the issuer). They're known as annuitization options because you've elected to spread payments over a period of years. Part of each payment is a return of your principal investment. The other part is taxable investment earnings. You typically receive payments at regular intervals throughout the year (usually monthly, but sometimes quarterly or yearly). The amount of each payment depends on the amount of your principal investment, the particular type of annuity, your selected payout option, the length of the payout period, and your age if payments are to be made over your lifetime.

Consider the pros and cons

An annuity can often be a great addition to your retirement portfolio. Here are some reasons to consider investing in an annuity:

- Your investment earnings are tax deferred as long as they remain in the annuity. You don't pay income tax on those earnings until they are paid out to you.
- An annuity may be free from the claims of your creditors in some states.
- If you die with an annuity, the annuity's death benefit will pass to your beneficiary without having to go through probate.
- Your annuity can be a reliable source of retirement income, and you have some freedom to decide how you'll receive that income.
- You don't have to meet income tests or other criteria to invest in an annuity.
- You're not subject to an annual contribution limit, unlike IRAs and employer-sponsored plans. You can contribute as much or as little as you like in any given year.
- You're not required to start taking distributions from an annuity at age 70½ (the required minimum distribution age for IRAs and employer-sponsored plans). You can typically postpone payments until you need the income.

But annuities aren't for everyone. Here are some potential drawbacks:

- Contributions to nonqualified annuities are made with after-tax dollars and are not tax deductible.
- Once you've elected to annuitize payments, you usually can't change them, but there are some exceptions.
- You can take your money from an annuity before you start receiving payments, but your annuity issuer may impose a surrender charge if you withdraw your money within a certain number of years (e.g., seven) after your original investment.
- You may have to pay other costs when you invest in an annuity (e.g., annual fees, investment management fees, insurance expenses).
- You may be subject to a 10% federal penalty tax (in addition to any regular income tax) if you withdraw earnings from an annuity before age 59½, unless you meet one of the exceptions to this rule.
- Investment gains are taxed at ordinary income tax rates, not at the lower capital gains rate.

Choose the right type of annuity

If you think that an annuity is right for you, your next step is to decide which type of annuity. Overwhelmed by all of the annuity products on the market today? Don't be. In fact, most annuities fit into a small handful of categories. Your choices basically revolve around two key questions.

First, how soon would you like annuity payments to begin? That probably depends on how close you are to retiring. If you're near retirement or already retired, an immediate annuity may be your best bet. This type of annuity starts making payments to you shortly after you buy the annuity, typically within a year or less. But what if you're younger, and retirement is still a long-term goal? Then you're probably better off with a deferred annuity. As the name suggests, this type of annuity lets you postpone payments until a later time, even if that's many years down the road.

Second, how would you like your money invested? With a fixed annuity, the annuity issuer determines an interest rate to credit to your investment account. An immediate fixed annuity guarantees a particular rate, and your payment amount never varies. A deferred fixed annuity guarantees your rate for a certain number of years; your rate then fluctuates from year to year as market interest rates change. A variable annuity, whether immediate or deferred, gives you more control and the chance to earn a better rate of return (although with a greater potential for gain comes a greater potential for loss of principal). You select your own investments from the subaccounts that the annuity issuer offers. Your payment amount will vary based on how your investments perform.

Note: *Variable annuities are long-term investments suitable for retirement funding and are subject to market fluctuations and investment risk including the possibility of loss of principal. Variable annuities contain fees and charges including, but not limited to mortality and expense risk charges, sales and surrender (early withdrawal) charges, administrative fees and charges for optional benefits and riders.*

Variable annuities are sold by prospectus. You should consider the investment objectives, risk, charges and expenses carefully before investing. The prospectus, which contains this and other information about the variable annuity, can be obtained from the insurance company issuing the variable annuity or from your financial professional. You should read the prospectus carefully before you invest.

Shop around

It pays to shop around for the right annuity. In fact, doing a little homework could save you hundreds of dollars a year or more. Why? Rates of return and costs can vary widely between different annuities. You'll also want to shop around for a reputable, financially sound annuity issuer. There are firms that make a business of rating insurance companies based on their financial strength, investment performance, and other factors. Consider checking out these ratings.

Sincerely,

John Kent Kidwell