Annuity Owner Mistakes

Tips and Ideas That Could Save You Thousands

Provided to you by

Barry Unterbrink

Retirement Planning Counselor

Annuity Owner Mistakes

Written by Javelin Marketing, Inc.

Provided to you
by

Barry Unterbrink
Retirement Planning Counselor
A270522 FL

Introduction:
Fixed Annuities, a Great Idea, But....

Annuities can be a great way to make your money work, but many people may not understand the risks, rewards, or the workings of their annuities!

This booklet will point out some common mistakes to avoid and show you how to get a lot out of your annuity. You'll get an education and real understanding of your annuity, **in plain English**!

Additionally, this booklet will point out some "hidden" values of annuities that many people are not aware of.

If you find that you have questions after reading the booklet, feel free to call the representative that has provided you with this booklet. The representative's phone number is on the last page.

Let's get started...

A Closer Look at the 1035 Annuity Exchange. Does It Make Sense for Me to Change Annuities?

If you have an annuity contract of any kind, you may have been approached about the idea of exchanging it for a new model or one with the latest features. A 1035 exchange could help you to achieve these objectives. 1035 refers to a provision in the federal tax code ("Code") that allows you to transfer the accumulated funds in an existing annuity to another annuity without creating a taxable event. In other words, the earnings from your original investment continue to receive tax−deferred treatment until you take money out of the annuity.

But the continuing tax benefit comes with some important conditions. First, the Code says the old annuity contract must be *exchanged* for a new contract. Therefore, you should have your current annuity company send the account funds directly to the new company. Secondly, the Code says you can make a tax−free exchange from: 1) a life insurance contract to another life insurance contract or an annuity contract or 2) from one annuity contract to another annuity contract. You cannot, however, exchange an annuity contract for a life insurance contract.

Why might you want to exchange or roll over an annuity? Here are some questions to consider on this:

1. How safe is my annuity investment? For any annuity product, the safety of your money is backed by the claims−paying ability of the issuing insurance company, not any government agency. So you need to make sure that the issuing company is in sound financial health. Annuity owners will sometimes exchange to a company with greater financial stability.

2. How does the current interest rate compare to the original contract rate? Some fixed annuity products offer competitive initial rates to attract investors. However, the interest rate might only be guaranteed for a limited period of time, say one or two years. With this in mind, your current renewal rate could be lower than what you might otherwise get on a new annuity.

3. Is my annuity lacking some of the newer annuity benefits? In a highly competitive business, many annuity companies work to offer new insurance features, such as interest rate guarantees, bonuses, guaranteed death benefits, long−term care riders and guaranteed income payments to attract investors. Therefore, you could find that a new annuity may better meet your needs or provide you with the opportunity for competitive returns.

Whether or not an annuity exchange makes sense depends on your existing policy and your individual financial situation. Although the thought of switching annuities might, at first, appear to be in your best interests, you should always consider the costs that will often be involved to do this.

Your consideration of the consequences should also take into account the following additional questions:

4. What is the total cost to me of this exchange? Although income taxes continue to be deferred, there are some other costs to consider before making the switch. For example, will the annual fees or other charges assessed by the new insurance company offset the higher interest or bonus payments? Does the surrender charge justify the added benefits? What are the comparative costs associated with the guaranteed benefits and investment options?

5. How do the surrender provisions compare? One of the biggest transactional costs that often comes into play for any annuity exchange is the surrender charge. For many companies, surrender charges eventually expire with an existing contract after a certain period of time. However, a new contract could increase these charges and could even increase the period of time in which the surrender charges apply.

6. What are the new features being offered and why do I need or want those features? For example, you might realize the life insurance guarantee or long−term care benefit rider is not really needed if other resources already exist. Of course, just the opposite could hold true if you need the coverage and cannot find a life or long−term care insurer to take you because of health reasons. You should also consider whether there are any limitations that apply to the features? For example, if there is a guaranteed interest rate, then how long does it last? Although the current interest rate for one company might be better, it's also important to consider past payment history. Also, what are the relevant expenses? Do they justify the benefits?

Keep in mind that a 1035 exchange does not provide a permanent income tax exclusion for gains on such exchanges, but merely a deferral−since the basis of the contract given up is carried over as the basis of the new contract received.

The representative who has provided this booklet has also provided a phone number for you to call if you would like to find out whether an annuity exchange can benefit you.

How Your Annuity Payments Are Taxed

Getting the most value from any annuity arrangement begins with an understanding of the relevant income tax rules. This helps us to understand how much income taxes will be taken from our annuity payments during retirement. This article will discuss some important tax rules you need to be aware of with respect to annuities.

The income tax rules that apply to all annuity payments start with Section 72(b) of the Internal Revenue Code ("Code"). This rule begins with the idea that every person should be allowed to recover his or her own contributions to a non−qualified annuity free of tax. This makes perfect sense, as your own non−qualified contributions were paid for with after−tax money. Your personal investment in a non−qualified annuity is commonly referred to as your cost basis.

The Code allows you to recover your cost basis gradually over the time you are receiving annuity payments. So, out of each payment received by you, a portion will represent a tax−free return of your basis. The amount of the payment that exceeds the basis portion is subject to federal income taxes at your respective tax rate. This will range anywhere from 10 to 35%, depending on your income level during your retirement years.

To understand how this works, let's look at an example. First, let's assume that our annuity owner, who is a non−smoking 60−year−old male and in good health, invests $250,000 of his own funds into a fixed deferred annuity that will start making income payments to him for the rest of his life when he turns 65. Let's assume that this taxpayer will pay income taxes at a 15% marginal rate when he retires.[1] Let's also assume that the annuity payments in our example come to $2,164 based on the accumulated value of $304,000 when the annuity owner starts taking payments.[2] Now we have enough information to determine the federal income tax on the annuity.

Looking at the life expectancy tables published by the Internal Revenue Service, we would see that the life expectancy established by these tables for a 65−year old male is 85 years of age. Based upon the initial investment, annuity payment, and life expectancy, the annuity owner will be allowed to exclude $1,042 of each annuity payment from income taxation.[3] Once we apply the 15% rate to the remaining portion of the payment, we come up with a federal income tax of $168 for each annuity payment.[4] Here's a breakdown of how the excluded part of the annuity payment was calculated:

$$\frac{\text{Investment In Contract}\ (\$250{,}000)}{\text{Expected Payment over Life}\ (\$2{,}164 \times 12 \text{ mo} \times 20 \text{ yr})} \times \text{Payment}\ (\$2{,}164) = \boldsymbol{\textit{\$1,042 Excluded Amount}}$$

[1] Married couples filing joint returns are taxed on the first $65,100 of their taxable income at the lower 10% and 15% rates (2008 IRS tax tables).
[2] American National Life, assumes 4% during deferral period and life payout based on January 2007 monthly rates of $7.12 per $1,000, male age 65.
[3] Reg. 1.72−9 (Table V).
[4] ($1122 multiplied by 15% tax rate).

In the event of an unfortunate death prior to the life expectancy, the Code still allows you to recover your unused cost basis by taking this as a deduction on the final tax return. For example, if we assume in our previous example that something happened to the annuity owner in the fifteenth year, he would be entitled to a $62,520 deduction on the final return.[5] On the other hand, if annuity payments are received after the life expectancy period, then the entire amount of these payments are subject to taxes.

Like all annuity guarantees, annuity payments are subject to the claims−paying ability of the issuing company. The payment assumptions were taken from a hypothetical annuity illustration of a healthy male who is eligible for preferred underwriting rates. Your results could vary based, among other things, upon your age, income and tax rate status, contribution, annuity payment beginning date, health and tobacco−user status. Please also note that tax laws are subject to frequent changes. You should therefore consult with your tax advisor regarding your individual circumstances.

Feel free to call the representative who has provided this booklet to you.

[5] (1042 x 12 mo) x 5 remaining years = $62,520 deduction on final return.

An Annuity That Offers Market Participation

Choosing a suitable vehicle for your retirement is not an easy task. With the numerous choices, which product is better suited for your needs? On one hand, you might want the guarantee of principal and past earnings. On the other hand, many prefer the potential of higher returns by being linked to the equity markets.

Would you like an annuity that tracks the performance of the stock market, yet helps to protect your principal when the market declines? The equity−indexed annuity could help you to cover these objectives.

The equity−indexed annuity can offer some market risk protection, tax deferral, a minimum interest rate guarantee, probate savings, and guaranteed minimum income payments for life. The interest earnings for these annuities are based upon the growth in an accepted equity index, such as the SP500 Index, Dow Jones Industrial Average, and Russell 2000. The interest rate applied to these annuities is based upon the overall movement of the index.

Many of these annuities will base the interest rate upon a pre−determined percentage of the market movement. For example, let's assume for illustration purposes that the annuity company set its participation rate at 50% of the index movement of the SP500. Let's assume that the SP500 had a good year and increased by 30% (this is a hypothetical assumption and is not based upon the performance of any particular investment). Let's also assume that the interest rate could actually move as high as 15% before any rate limitations were applied. Based upon the facts of this example, the interest rate that would apply to this hypothetical account would be 15% (before contract fees and expenses are subtracted from the account balance). Please note that participation percentages do vary among companies and can range anywhere from 50% to 90%.[6] Some companies also set a cap on the interest rate, which can vary from company to company (typically between 10% or less).

The second fundamental feature of these annuities is the market risk protection. In the event that the market index should go down, this feature will help prevent your principal investment from being reduced below a certain percentage of your principal investment. The minimum guaranteed account value typically can also vary among companies and generally ranges anywhere from 75 to 100% of your premium, depending upon the type of product involved.

Notwithstanding the benefits previously discussed, there are many other things that should be considered before a purchase is made, including:

1. Surrender Fees. Like fixed deferred annuities, equity−indexed annuities have penalties for early withdrawal called surrender charges. These charges can result in a loss of your principal investment (see discussion below on withdrawals). These charges typically decline over the length of the surrender charge period (typically 5 to 15 years, depending upon the company).

2. Tax Consequences. These annuities are also suited for investors with long−term investment horizons. Withdrawals from these annuities prior to age 59½ can also subject the annuity owner to income taxes and an additional 10% income tax penalty on the distributed amount.

[6] Accuquote blog 9/17/07.

3. Features Vary Among Insurance Companies. There are many companies that are offering these types of annuities, and the methods of calculating the minimum and maximum interest rate vary greatly among them. Although many companies offer a minimum interest rate (typically ranging between 1.5 to 3%), some companies offer minimum interest rates as low as 0%.

4. Fees and Expenses. Asset management fees will be incurred on these annuities. Maintenance fees, sales commissions, trading costs and other contract charges could also apply. These charges will, in many cases, reduce the account value of these annuities.

5. Loans and Early Withdrawals. Although some companies do allow you to take minimal withdrawals without surrender charges, it is important to remember that some withdrawals can affect the amount of market downside protection provided under the contract.

6. Company Stability and Regulatory Oversight. All annuity features are guaranteed by the claims−paying ability of the issuing company. Please note guarantees associated with an equity index applies only if the annuity is held until the end of the contract term and that loss of principal is possible if the annuity is surrendered before the end of the contract term. Despite the market participation feature, the various state insurance departments regulate these products.

Do you want to know more about these annuities? Please call for more information.

Annuities Can Help Reduce or Eliminate the Tax on Your Social Security Benefits

Prior to 1984, Social Security income was tax−free. Today, however, taxpayers could be paying tax on up to 85% of their Social Security income.[7] The good news is that annuities can help reduce and sometimes eliminate the income tax on your Social Security income!

The IRS calculates the tax on your Social Security income based on your total income from all sources. However, income you earn on an annuity that is left to accumulate does not appear on your current tax return.

Therefore, annuities may reduce your total income for Social Security benefit taxation purposes. In fact, if you shelter enough income in annuities and bring your income below the thresholds (adjusted gross income of $25,000 for a single taxpayer and $32,000 for a married taxpayer) you then pay no tax on your Social Security income.

For your own benefit, please consult with a qualified tax advisor or attorney. Want to see if these calculations work to your advantage? Bring in a copy of your tax return (including Schedule B) to the rep who has provided this booklet to you. They should be able to let you know how much you could save in taxes.

Annuities can provide yet another benefit....

[7] Per IRS Publication 17, 2007, single individuals and married with modified adjusted gross incomes exceeding $34,000 and $44,000, respectively, pay tax on up to 85% of their Social Security income. The explanation of the tax treatment of payments under an annuity contract is found in IRS Publication 17, 2007.

Cash Payments for Life[8]

It's possible to get a fixed return on your money with a fixed immediate annuity.

Similar to other types of annuities, an immediate annuity involves a premium payment to an insurance company. In exchange, the company will immediately start making monthly payments to you. Part of these payments is considered income and part comes from your principal investment. These payments can last for a term of years or even for your lifetime if you so choose. Note that immediate annuity payments could incur premium taxes in some states. Maintenance expenses and contract fees charged by the insurance company could also reduce your payments. For a detailed discussion on annuity income taxes, please revisit the article appearing earlier this booklet.

The amount of money you receive each month is dependent on several factors, including your estimated life expectancy, the amount of money you have invested and the current interest rate being paid by the annuity company (which is locked in at the time of purchase). The payout will typically be higher the older you are because the insurance company does not expect to have to make payments as long as they would to a younger person. Assuming that you have chosen the lifetime payment option, your annuity company will continue to make payments to you even if you live past your normal life expectancy. If you die sooner, the insurance company keeps the balance of the annuity. You may also be able to elect to receive a lower payment in exchange for having the payments continued to your heirs until the entire amount of your original premium has been paid out.

For whom may a fixed immediate annuity be suitable?

- A retiree needing increased monthly cash−flow
- A person with no heirs or who is not concerned about leaving an estate
- Someone who has set aside other funds to leave to heirs if they desire to leave an inheritance
- A retiree desiring the fixed payment and wanting to avoid maturities, rolling over investments and the maintenance and administration required of investing on one's own

What can you expect to receive on an immediate annuity?

$100,000 Premium, Male	
Age	**Monthly**
65	$646
70	$707
75	$800

Life annuity payments, Comparative Annuity Reports, January 2008

[8] Subject to the claims−paying ability of the insurance company, please note immediate annuities are designed to enhance cash flow and save taxes but are not the only investment vehicles by which these goals may be achieved. Always consider all possible investment options before you invest.

Annuities Can Help Provide Insurance for Long−Term Care

More and more people know someone or have a family member who has needed long−term care. In fact, over half of those almost age 65 spend at least some time requiring nursing care.[9]

This is not medical care, but the type of care received in the home (shopping, meal preparation, assistance with bathing, eating, etc.) or in a nursing home.

As you know, ***Medicare does not usually pay*** for this care. People are left to pay for this in one of three ways:

1. Out of their own pocket (about $6,478 per month)[10]
2. Purchasing long−term care insurance while they are healthy
3. Qualifying for Medicaid (different than Medicare)

Many people cannot afford the $6,478 or more per month that some nursing homes charge. That's why many people are feeling the financial pinch within a year of entering a nursing home. This leaves many people exposed and unprotected from the catastrophic cost of long−term care.

The state government may pick up the tab for you, but you may have to spend down your assets. Depending upon your state's Medicaid rules, this could leave you with as little as $2,000 in liquid assets (Medicaid allowances do allow spouses to retain some additional assets). So, if you have $100,000 in the bank, you could be required to spend it on your care before the state provides any assistance. Prior to applying for Medicaid, it might be possible to shift some assets to the healthy spouse. Please note that transfers to other relatives could be subject to a look−back period of 60 months. If the transfer took place within the look−back period, the transferred asset will be counted as your property for Medicaid spend down purposes.

There are ways to shelter your assets, however, and qualify for Medicaid without spending down your assets! One option is to place your funds in an immediate annuity. These annuities (***when purchased in compliance with Medicaid rules***) may be exempt assets, depending on how much you get and the state where you live. Some states exempt annuity payouts only up to a certain amount. That means you can keep this asset and still qualify for Medicaid payments. This is one way to obtain government support for long−term care and not have to spend your last dime.

The rules on this are particular and vary by state so please consult someone knowledgeable on Medicaid procedures or call for more information.

[9] Penn State University Policy Research Institute 3/2/06.
[10] The MetLife Market Survey of Nursing Home and Care Costs, 2007. Survey calculations based on private room rates in licensed nursing homes for 87 metropolitan areas of all 50 states and the District of Columbia.

Summary

These are **only a few** ideas to help you better protect your annuity assets and make the most of what you worked hard to accumulate.

Financial and retirement planning can have an impact on your estate, even if your estate is of modest size.

- Find an advisor who is knowledgeable in senior matters.
- Find an advisor who will answer your questions as well as answer questions that you have not thought to ask.
- Find an advisor who will point out opportunities and caution you about risks and one who is knowledgeable about the special needs of retired individuals.

With the sound advice of experience and a conservative retirement plan, you and your family can get the most out of your assets.

About
Barry Unterbrink

Barry has held positions in the financial services industry since 1982. His experience includes portfolio manager for institutional pension funds, Investment Advisory President and financial newsletter publisher. A finance graduate of Stetson University, he currently operates as a fee−only Retirement Planning Counselor, helping clients in the Southeast. He has resided in Fort Lauderdale since 1968.

About
Stetson Wealth Management

As second generation investment counselors, my family and I have managed up to $100 million in accounts for individuals and retirement plans dating back to 1973. As independent advisors, Larry and Barry Unterbrink offer total objectivity in all our recommendations. As a Chartered Retirement Planning Counselor, let me help you make wise choices to ensure a comfortable retirement. More information can be found at our web site is at: www.stetsonwealthmanagement.com

- **INCOME PLANNING** − I offer you prudent choices in planning for your income needs through guaranteed fixed rate savings and investing vehicles.
- **CASH MANAGEMENT** − Let me show you safe money places for your shorter−term savings.
- **RETIREMENT PLAN MANAGEMENT** − Sill working? Let's get your retirement plan in order and build it before you retire: 401K, 457, TSA plans and others.
- **EDUCATION** − Need a speaker on money topics for your club or organization? Contact me to schedule an appointment and review of your needs.
- **CHECK ME OUT** − Please visit http://www.myfloridacfo.com/data/aar_alis1/ to check on my Florida agent license status, or call (850)413−3137

Phone today with questions or to see if we can help you.
There is no charge for an initial meeting.

Barry Unterbrink
Retirement Planning Counselor
Stetson Wealth Management
6278 N Federal Hwy St 195
Ft. Lauderdale, FL 33308
954−719−1151