Frequently Asked Questions
about Annuities

Annuities are solid investment options for people that prefer tax-deferred growth, capital preservation and modest, but guaranteed income streams. Get the answers to the most common asked questions about annuities before determining whether it's right for you.

Annuity Basics

What Is an Annuity

An Annuity is a financial contract between a Policy Owner — the Annuitant — and an insurance company — the issuer. It can be structured in a lot of different ways with a variety of custom features, including death benefit payments and inflation protection.

Despite the range of structures, all annuities share a fundamental similarity. They involve an upfront payment by the annuitant in exchange for a series of income distributions from the issuer.

The size, timing, variability and duration of the income distributions depend on how the contract is structured. For many people, this is determined as part of the retirement plan.

Who sells Annuities

Annuities are issued by insurance companies, but most contracts are not sold directly to consumers. Most annuities are sold via intermediaries, such as; distributors, brokerage firms, banks, mutual fund companies and independent agents. These intermediaries conduct most interactions with consumers but the insurance company backs the annuity.

What are (3) Benefits of a Annuity

Guaranteed stream of income

Annuities provide a GUARANTEED stream-of-income, which is vital for people without a Pension Plan, but can be invaluable if something happens to Social Security Income.

Tax-deferred growth

Annuities facilitate tax-deferred growth, which can have a powerful compounding effect on your savings. But unlike 401(k) plans and individual retirement accounts, there are no contribution limits for annuities.

Stability

Annuities offer stability during turbulent economic periods. The downside protection is ideal for conservative investors that are unable to withstand market shocks.

In addition to these prominent benefits, some annuities offer the potential for joint life payments, death benefit payments and inflation protection.

What are (3) Draw-backs of an Annuity

They are complex

Annuities are complex financial contracts with lots of intricate terms and conditions. This can be overwhelming for the average investor. You should consult with a fiduciary investment advisor before purchasing an annuity.

They are illiquid

Annuities are illiquid investments that often have lengthy accumulation periods before distributions begin. This is problematic for people with significant near-term cash needs.

They have commissions and fees

Some annuities have costly commissions and fees. Excessive charges can eat into your hard-earned savings and diminish your income stream.

Annuity Rates

Annuity Rates - vary from issuer to issuer, depending on the structure of the contract and the leniency of the issuer. So, an annuity rate is usually reflective of a few key factors, including the current interest rate environment, the life expectancy of the annuitant and the inclusion of customized features, such as inflationary adjustments, lifetime payments.

Annuity Taxation

Taxes on an Annuity - depends on whether it is a qualified, or a non-qualified annuity. A qualified annuity is a tax-deductible investment (made with pre-tax dollars), while a non-qualified annuity is an after-tax investment. Qualified annuities allow for a tax deduction in the year of purchase — non-qualified annuities do not provide for a tax break. The interest income earned by both types of annuities is allowed to grow on a tax-deferred basis.

Will my beneficiary have to pay taxes on the Annuity

Yes, annuity payments disbursed to a spouse or beneficiary will be treated as taxable income.

What Is the Exclusion Ratio?

The exclusion ratio is a percentage that represents the portion of a non-qualified annuity distribution that is excluded from gross income and, therefore, not subject to ordinary income tax. It exists because a portion of each non-qualified distribution is a return of your principal (which has already been taxed) and a portion is interest income (which has never been taxed).

Incidentally, the exclusion ratio is not applicable to a qualified annuity, because both the principal and interest income associated with this type of vehicle are fully taxable.

Difference between Qualifies and Non-Qualified Annuities

A Qualified Annuity is purchased with *pre-tax* dollars, while a Non-Qualified Annuity is purchased with *after-tax* dollars.

When you receive a distribution from a qualified annuity, the entire amount — principal and earnings — is subject to ordinary income tax.

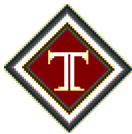
An annuity purchased with non-qualified sources of money is automatically classified as non-qualified. With a non-qualified annuity, since you already paid tax on the money used to make the purchase, only the earnings are taxable.

Another important distinction relates to the money used to purchase the annuity. A qualified annuity can only be purchased with money from another type of qualified vehicle, such as a traditional 401(k) plan or a traditional individual retirement account (IRA).

Associated Fees with Annuities

Common Fees

- Administrative Fees cover ongoing servicing cost of the annuity contract.
- Investment Management Fees cover the costs of managing the annuity's underlying Portfolio of Assets associated with a Variable Annuity.
- Surrender charges are a potential fee for an annuitant making premature withdrawals. However, most Annuities allow up to a 10% withdraw without a surrender charge fee.



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