Annuity Owner Mistakes

Tips and Ideas That Could Save You Thousands if not More!

Provided to you by:

Kevin Wenke

Certified Financial Planner™

Annuity Owner Mistakes

Kevin Wenke CFP® CLU®

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 plus some information on how certain annuities work.

If you find that you have questions after reading the booklet,

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. The reason comes down to the way these types of contracts are taxed. Life insurance's death benefit is 100% income tax free and any gains above the premiums contributed can be borrowed from the contract, while the insured is still alive, without incurring a taxable event. This is like taking out a home-equity loan on a house. On the other hand, an annuity's appreciation/death benefit are potentially taxed when removed from the contract on a "last in/first out" basis. This simply means that when any money is taken out of an annuity, the gains are deemed to be taken first (which are taxable if the contract is held in a taxable account.) The government is smart enough to know **not to allow** people to move their money from a **less tax favored product** (annuity) **to a potentially more tax favored product** (life insurance) and **avoid taxes in the process**. You can however do the opposite and move money from a more tax favored product (life insurance) to a less tax favored product (an annuity) and possibly put yourself in a position to pay more tax at a future date.

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 consider 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?

IMPORTANT: Again, 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.

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. Depending on the type of account the annuity contract is held and the way you decide to take income from it, the tax consequences will vary.

I. When The Annuity Contract is Annuitized

Continuing the discussion from the previous section, the income tax rules that apply to all annuity payments, upon "annuitization", start with Section 72(b) of the Internal Revenue Code ("Code"). When a contract owner decides to take "periodic and equal payments" to receive income from an annuity, 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 when you annuitize a contract. 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 37% (in 2020), depending on your adjusted gross income level the year you take the income plus any state income taxes you may be subject to.

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 22% marginal rate when he retires.[1] Let's also assume that the monthly annuity payments in our example come to $1,497[2] when the annuity owner starts taking payments (principal and interest for life). 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 is 85 years of age. Based upon the initial investment, annuity payment, and life expectancy, the annuity owner will be allowed to exclude $898 (60%) of each annuity payment from income taxation.[3] Once we apply the 12% rate to the remaining portion of the payment, we come up with a federal income tax of $72 for each annuity payment.[4] Here's a breakdown of how the excluded part of the annuity payment was calculated:

$$\frac{\text{Investment In Contract } (\$250{,}000)}{\text{Expected Payment over Life } (\$1{,}497 \text{ x } 12 \text{ mo x } 20 \text{ yr})} \text{ x Payment } (\$1{,}497) = \textbf{\$898 Excluded Amount}$$

Married couples filing joint returns are taxed on the first $80,250 of their taxable income at the lower 10% and 12% rates (https://www.irs.gov/pub/irs-drop/rp-19-44.pdf 12/20/19)

[2] www.immediateannuities.com 12/20/19

[3] Reg. 1.72-9 (Table V) irs.gov

[4] ($599 multiplied by 12% tax rate).

[5] (898 x 12 mo) x 5 remaining years = $53,880 deduction on final return (see next page.)

In the event of an unfortunate death prior to the life expectancy, the tax code still allows you to recover your unused cost basis (if there isn't a death benefit attached to the annuity contract) by taking this "loss" 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 $53,880 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.

II. When Withdrawals Are Taken From An Annuity

An annuity contract owner does not have to annuitize a contract in order to receive income from it. Many contracts allow for "withdrawals" from the annuity principle.

During the time an annuity owner contributes to a contract, 100% of the earnings in the contract are income tax deferred. When the contract owner wants to withdraw money, it is removed from the contract in a "last in/first out" basis. If you think about this, the money you put into the contract (the first money in) earns interest (the last money to be credited to the contract) so the IRS says it is the earning that are removed first. These earnings, when removed, are taxed at the recipient's marginal tax bracket the year they are received. If a withdrawal is taken before age 59 ½, the income may also be subject to an additional 10% penalty.

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
- Start date of your annuity payment
- Health
- Tobacco use status

Please also note that tax laws are subject to frequent changes. You should therefore always work with a team of advisors who understand your unique individual circumstances.

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 S&P 500 Index, Dow Jones Industrial Average, and Russell 2000. The interest rate applied to these annuities is based upon the overall movement of the index.

It is important to understand that the principal balance of an Equity Indexed Annuities IS NOT INVESTED INTO THE STOCK MARKET. Instead, the insurance company issuing them invests the money into their own “General Account” which is highly regulated by the insurance commission of the state the contract was issued in. This helps to ensure that these moneys are invested in a conservative manner so that they are not subject to the volatility that is inherent to investing into stocks directly.

Your next question may be “how do Equity Indexed Annuities follow the returns of stock indexes if they are not invested into stocks” and the answer is quite simple. The insurance companies take the interest they earn and purchase their own type of insurance contract with these proceeds called a “stock option.” These stock options grant the insurance company (and ultimately the annuity owner) the right to have a positive return when the underlying stock index increase. However, if the index were to fall in value while the insurance company owned the stock option, the contract would not have value when they expire BUT the principal value of the annuity would be unaffected and available for the insurance company to repeat the process or the contract owner to withdraw their funds.

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 S&P 500. Let's assume that the S&P 500 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 amount the contract can earn during any given period. These caps vary from company to company so if you believe one of these contracts is the right solution for your situation, it is important to utilize a company like Decision Tree Financial who has access to over 100 insurance companies and will find the best contract for your situation.

The second fundamental feature of these annuities is the market risk protection. As stated earlier, in the event that the underlying stock market index should go down, this feature will help prevent your principal investment from falling. These contracts are “fixed” contracts and it is the issuing insurance companies contractual obligation to perform as specified in the contract.

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.

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. Cap-Rates - Most indexed annuities include a yield or rate cap that sets the limit the amount that's credited to the accumulation account. For example, a 7% rate cap limits the credited yield to 7% no matter how much the stock index gained. Rate caps typically range from a high of 15% to as low as 4% and are subject to change. (Learn How Decision Tree Financial

5. 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.

6. 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.

7. 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 844-433-2474 for more information.

[6] http://www.allthingsannuity.com/best_indexed_annuity.htm 12/20/19

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 more information visit:

https://decisiontree.financial/how-taxes-are-determined-on-social-security/

Want to see if these calculations work to your advantage? Bring in a copy of your tax return (including Schedule B) to your first meeting with us. We will be able to develop a comprehensive tax strategy in order to keep Uncle Sam out of your pockets. Annuities may be one solution but at Decision Tree Financial, we look at every angle to put more money in your pocket…

Annuities can provide yet another benefit....

[7] Per www.irs.gov Publication 17, 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.

Cash Payments for Life[8]

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

Like 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 in 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.[9] 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	$525
70	$599
75	$717

Life annuity payments, Comparative Annuity Reports, December 2019, male, $100,000 investment https://www.immediateannuities.com/pdfs/comparative-annuity-reports/Current-Issue.pdf

[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.

[9] Insured Retirement Institute http://www.irionline.org/resources/resources-detail-view/planning-for-health-care-how-excellent-health-and-longevity-impact-retirement-income-planning

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 over age 65 will spend at least some time requiring nursing care.[10]

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 $7,513 per month)[11]
2. Purchasing long-term care insurance while they are healthy
3. Qualifying for Medicaid (different than Medicare)

Many people cannot afford the $7,513 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 before you do anything, be sure to consult with someone knowledgeable on Medicaid procedures!

---

[10] Morningstar "75 Must-Know Statistics About Long-Term Care" 8/31/17 http://news.morningstar.com/articlenet/article.aspx?id=823957
[11] Genworth Long Term Care Costs - Cost of Care Survey 2019, national median semi-private room cost of $7513 monthly. https://www.genworth.com/aging-and-you/finances/cost-of-care.html

Summary

This is just some of the information you may be looking for about fixed annuities. The main concept to know is that they are **INSURANCE CONTRACTS** that have features and benefits that investments do not.

How you can use an annuity you own or are thinking of buying depends entirely on your own unique situation.

So What Is Your Next Step?

If you are serious about making the **best financial decisions** with your money so you can **stop the time consuming process of participating in an endless search for more information** while also putting yourself in a position to **avoid getting sold worthless financial advice** then you will want to know about my company's **Wealth Performance and Protection System.**

You can click here or type this address into your internet browser

www.DecisionTree.Financial/WPPS/

It is **100% Guaranteed** to help you make the best financial decisions when it comes to not only buying annuities but also a number of other important financial topics so that you can:

- ✓ Have **More Money** for Yourself…
- ✓ Have **More Time** to Do What it is You Want to Do…
- ✓ Have **More Confidence** and **Less Worry** When Making Financial Decisions…
- ✓ **Higher Investment Returns** with **Less Risk**…
- ✓ **Pay Less Taxes** and Keep Uncle Sam Out of Your Pocket…
- ✓ Organize **Your Financial Life** so it is **Coordinated, Optimized and Efficient** and…
- ✓ So much more!

But you have to hurry! You see, I WANT TO HELP EVERYONE I POSSIBLY CAN! Unfortunately, I only have so many hours in a day and with the number of books we have downloaded each day, there are only so many spots available to take advantage of the WPPS which **I guarantee** will change your life for the better when you participate!

So don't wait a minute longer and learn more about the WPPS now by clicking here: https://www.DecisionTree.Financial/WPPS

<u>Who Am I – What I Do - Why I Do It</u>

Odds are this may be the first time you have ever heard of me so you are probably wondering – **Who is this person, what does he know, why should I trust him and how can he help me.**

My name is Kevin Wenke and here is a little bit about me and my background:

Education

- Bachelor's Degree in Biology from SUNY Fredonia
- MBA from The University of Tennessee, Knoxville

Awards, Titles, and Designations

- Certified Financial Planner™
- Chartered Life Underwriter
- Author (As you probably figured out)

Other Information

- I have taught financial planning courses at:
    - The **University of Central Florida** adult education program
    - The **Orlando Florida Police Department**
    - **Kennedy Space Center** for **NASA** employees through their employee assistance program
- Teach continuing education classes at **Gold Coast Schools** for insurance agents, accountants, and attorneys on topics like Social Security, Medicare and Annuities.

I HAVE FIRSTHAND UNDERSTANDING OF THE IMPORTANCE OF HAVING A SOLID FINANCIAL PLAN.

I am a **two-time cancer survivor.** Hodgkin's Disease the first time and Esophageal the second time. Having lost everything the first time, I put the right financial plan in place before the second diagnosis which allowed me to focus on treatment, not money so I could beat the odds and be here today.

Having my health back and with clients across the country (as well as some in Europe and Africa) I spend my time living between the little town I grew up in called Olean, New York and Florida helping people understand how to organize their financial life in a way that helps them have the type of life they want for themselves.

I have a ton of experience, both in life and professionally, along with a team behind me that can help put together a plan that can help you have the life you desire!

So don't wait a minute longer and learn more about the Wealth Performance and Protection System now by clicking here - https://www.DecisionTree.Financial/WPPS so that you can take find out how we can help achieve more and claim your spot before they are gone!

This Page Left Intentionally Blank

Kevin Wenke CFP® CLU®

Phone: (844) 4DECISION
(844) 433-2474

Decision Tree Financial PLLC
Kevin@DecisionTree.Financial
Orlando, Miami, Boca Raton Florida
Olean New York