



ANNUITY MAXIMIZATION STRATEGY

*An estate planning technique for
individuals who own deferred
annuities with sizable growth.*



Transamerica Occidental Life Insurance Company



Preserving Hard-Earned Assets

As part of a solid financial plan, many people purchase deferred annuities as an accumulation vehicle that also helps to delay federal and state income taxes. The good news is that, over the years, the contract has probably grown substantially in value. And the bad news? Despite the advantage of income tax deferral, these annuities may lose a sizable portion of their value at the owner's death.*

A Taxing Example

Mike Megaworth purchased a \$150,000 deferred annuity contract 20 years ago, earning an average of 6% annually. He is now 70 years old and the annuity is worth \$481,070. Mike has a taxable estate of \$2,481,070 in the 46% marginal federal estate tax bracket. His daughter, Martha, is the beneficiary of the annuity contract and is in the 35% federal income tax bracket. What would happen to the contract's account value if Mike were to die and it were left to Martha?

Contract value at death	\$481,070
Estate tax	- 221,292
Income tax**	- 62,572
Value retained by beneficiary	\$197,206

The above example is for illustrative purposes only. It does not address the impact of applicable state income and death taxes, nor does it reflect any deductions and credits that could be available to reduce the overall estate and income tax liabilities under certain circumstances.

**Tax deferral is only available to individuals. It is not available for annuities owned by entities such as corporations and most types of trusts.*

***After an allowance for the original cost basis of \$150,000 and an income tax deduction of \$152,292 for estate taxes attributable to the income element of the contract $[0.46 \times (481,070 - 150,000)]$, \$178,778 of the contract's value would be subject to income taxation at 35%.*

Why Deferred Annuities Lose Almost Half Their Value

As the example shows, even after 20 years of tax-deferred savings, Martha would only receive a little less than half of the contract's value. A significant amount—59%—would be lost to taxes.

Here's why: Under current tax laws, at the annuity owner's death, contract gains are completely income taxable to the beneficiaries as income in respect of a decedent (IRD), while other assets, such as individual stocks, receive special tax treatment (a step-up in basis), which may reduce the income tax liability if they are sold by heirs. Plus, during the owner's lifetime, any amount of gain received from an annuity contract is taxed as ordinary income. There may also be an additional 10% federal income tax penalty on the taxable portion of the amounts received if the owner is under age 59^{1/2}.

Payments from the annuity will be subject to ordinary income tax rates even if the annuity holds a type of investment, such as stocks or bonds, which would typically be subject to the capital gains rate. Moreover, the contract's value may be subject to estate taxes at the owner or spouse's death.

Annuity Alternatives Offer Choices

There are alternatives to help protect financial assets, increase current income stream, or decrease income tax liabilities.

Option One: Annuitizing the Contract

- ❑ The contract owner elects to receive a guaranteed income from the annuity for either the owner's lifetime, or the joint lifetimes of the owner and a spouse.
- ❑ This technique may reduce overall income tax liabilities when compared to surrendering the contract, since the owner will recognize taxable income over a number of years rather than in just one tax year.
- ❑ If the annuity owner is also receiving Social Security benefits, it's less likely that the receipt of annuity payments will affect the taxation of these benefits in any one year than if the owner had surrendered the entire contract.
- ❑ Since the annuity payments will stop in a number of years or with the owner's (and/or spouse's) death, there should be less, and may be no, annuity value included in the owner's or spouse's taxable estate. However, the family may still lose a portion of the remaining funds related to the deferred annuity contract's value.



Option Two: Taking Periodic Withdrawals

- Rather than selecting an annuity option, the owner can also take withdrawals from the annuity contract for periodic income needs.
- For annuity contracts purchased after August of 1982, these withdrawals will be taxed first from the gain or interest portion of the contract, unless the contract has no interest or gain portion. This is referred to as “LIFO”—“Last in, first out.”
- Furthermore, if the contract owner is under age 59½, there may be an additional 10% federal income tax penalty on the taxable portion of withdrawals.
- Depending on amounts needed, company-imposed surrender charges may also apply.

Purchasing Life Insurance

Under either of the options previously discussed, the annuity beneficiaries will likely see a reduction in their inheritance at the death of the annuity owner. Therefore, depending on risk tolerance and financial goals, the annuity owner can purchase a separate life insurance policy. Unlike the deferred annuity contract, the life insurance policy can generally pay its benefits to beneficiaries income tax-free. In addition, if the policy is owned by a third party—such as the adult children or an irrevocable trust—the life insurance policy and proceeds may be kept out of the taxable estate.

The annuity owner may want to use a portion of the annuity income to pay for the life insurance policy premium. If the annuity owner chooses the withdrawal option rather than annuitizing the contract, he or she must be over age 59½ to avoid the 10% federal income tax penalty. If the policy is owned by a third party such as a trust, there may be gift taxes associated with the money used to pay the life insurance premiums. However, annual exclusions and lifetime credits may offset any gift tax liabilities.

Who Can Benefit from the Annuity Maximization Strategy?

- Individuals who want the death benefit protection and cash accumulation values of a permanent life insurance policy
- Annuity contract owners interested in maximizing an inheritance for their loved ones

Mission Accomplished: Estate Enhancement

Life insurance is the key to this planning strategy. Policy proceeds are generally paid to beneficiaries income tax-free and, if structured properly, can be kept out of the taxable estate. As a result, the family's legacy is protected for future generations.



Annuity Maximization Strategy Fact Finder

Client Information

Name

Date of Birth

Smoker/Nonsmoker

Risk Class

Owner _____

Spouse _____

Is spouse joint owner? Yes No

State of Residence: _____

Owner's Income Tax Bracket: _____% Owner's Estate Tax Bracket: _____%

Beneficiary's Income Tax Bracket: _____%

Current Value of Annuity: \$ _____ Annuity Cost Basis: \$ _____

Annuity Contract Value Growth Rate: _____%

Initial Life Insurance Policy Death Benefit: \$ _____

Taxes on Withdrawal Paid Out of Pocket? Yes No

Life Insurance Product to Illustrate: _____

Cash Surrender Value at Age 100: _____

Endow Equal to Initial Face Amount: _____

The proposal will assume annual premium payments through insured's age 100 (younger insured's age is used with survivorship policies).

Select "Annuity Maximization" option under illustration type to illustrate taking withdrawals from an existing deferred annuity contract to pay for life insurance policy premiums.



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Life insurance policies are issued by Transamerica Occidental Life Insurance Company, Cedar Rapids, IA 52499. All policies may not be available in all jurisdictions.



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OLA 1005 0606 Annuity Maximization Brochure (Fact Finder)



Despite the advantage of tax-deferred growth on the account value, deferred annuities may lose a sizable portion of their value at the owner's death.

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