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The Split Annuity: Current Income Plus Future Savings

Annuity guarantees, including, but not limited to, immediate annuity guarantees and fixed-interest deferred annuity guarantees, are based on the claims-paying ability of the annuity issuer. Withdrawals from an annuity prior to age 59½ may be subject to a 10% federal income tax penalty.

Financial planning in retirement usually has two primary goals: create a steady, dependable stream of income and preserve retirement savings. One idea which may assist in achieving these retirement objectives is the split annuity concept.

What is a split annuity?

An annuity is a contract purchased from an insurance company that can be used to accumulate money on a tax-deferred basis for retirement and/or to convert retirement assets into a stream of income. A split annuity isn't really one annuity, but a combination of two or more annuities funded with a single sum of money. A portion of the money is placed in an immediate annuity that makes a fixed payment to you for a fixed period of time, such as ten years. The balance of the money is invested in a fixed-interest deferred annuity, which accrues sufficient interest to equal the beginning sum used to fund both annuities by the time the immediate annuity payments stop. The amount of income you receive depends on the amount of money paid into each annuity, and the terms and interest rates applicable to each contract.

Example of Split Annuity $100,000 investment	
Immediate Annuity	**Deferred Annuity**
$41,457 generates annual payments of $5,136.76 for 10 years	$58,543 at 5.50% per year will grow to $100,000 by the end of 10 years
This example assumes a total initial investment of $100,000. This is a hypothetical illustration and does not reflect actual annuity products or performance. Withdrawals from an annuity prior to age 59½ may result in a 10% penalty tax imposed by the IRS. Guarantees are subject to the claims-paying ability of the issuer.	

Split annuity benefits

Fixed income --The immediate annuity makes fixed payments to you for a fixed period of time, regardless of changing interest rates or stock market fluctuations.

Possible tax-advantaged payments --The tax code treats payments received as an annuity as being divided into two parts: a nontaxable portion that represents the return of premiums paid into the annuity, and a taxable portion that corresponds to the earnings in the annuity. As a result, only a portion (i.e., the earnings) of each payment is included in your gross income. The remainder is a return of principal and not taxed.

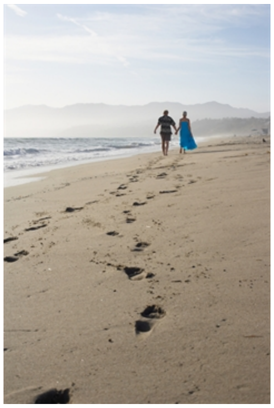
Tax-deferred accumulations --The earnings on a fixed-interest deferred annuity (i.e., the interest earned on your money) are tax deferred until withdrawn. Unlike most taxable investments, you pay no taxes on your annuity earnings until you begin to take payments or receive income. Income tax deferral allows your money to potentially grow faster than in a taxable account, because earnings that otherwise would be subject to taxes are available for growth.

Flexibility --The fixed-interest deferred annuity can provide a new income stream at its maturity. Also, most fixed-interest deferred annuities allow you to withdraw a portion of the annuity's cash value without penalty. This option provides you with access to additional money should you need it in addition to the immediate annuity payments.

Return of principal --At the end of the immediate annuity payout period, the fixed-interest deferred annuity is worth the original amount of your investment in both annuities. At that time, you can use the money from the fixed-interest deferred annuity however you wish, including another split annuity.

Split annuity limitations

Surrender or early withdrawal charges --The fixed-interest deferred annuity usually has early withdrawal or surrender charges. This assessment is often a percentage of a withdrawal exceeding any applicable penalty-free amount allowed in the annuity



A split annuity isn't really one annuity, but a combination of two or more annuities funded with a single sum of money.

contract. Most fixed-interest deferred annuities include some exceptions to the withdrawal charge, including withdrawals due to disability, loss of employment, long-term care, and death of the annuity owner.

Fixed annuity payments --While knowing that you will receive a fixed payment for a fixed period of time may be comforting, it may also prove inconvenient if you need or want more income. Typically, immediate annuity payments are fixed once they've begun, although there are some exceptions (such as inflation adjustments and commuted payment options) that allow for withdrawals from the balance of the immediate annuity in addition to the fixed payments.

Lower deferred annuity interest rates --The appeal of the split annuity idea is knowing that at the end of the immediate annuity payout period, the fixed-interest deferred annuity will have earned enough interest to equal the principal amount used to fund both annuities. The growth of the fixed-interest deferred annuity portion of the split annuity is based on the interest rate paid by the annuity issuer. The immediate annuity payments are based, in part, on the amount apportioned to the immediate annuity. The more money allocated to the immediate annuity, the larger the income payments. If more money is allocated to the fixed-interest deferred annuity because of lower interest rates, then less money is allocated to the immediate annuity, decreasing the payments to you.

Split annuity uses

While the split annuity concept is not the only alternative for pursuing a particular financial objective, it may be useful in a number of situations.

Dependable income and savings--Many people, especially retirees, want a dependable income coupled with preservation of retirement funds. The split annuity concept may offer a means to both objectives. Not only does the immediate annuity pay a fixed income for a fixed period of time, but a portion of each payment received from the immediate annuity may not be subject to income tax because it is considered a return of premium. Immediate annuity payments are fixed and don't fluctuate during the payout period, regardless of changing interest rates. Moreover, the deferred annuity part of the concept offers a fixed interest rate on that portion of the money allocated to it. Most deferred annuities also allow for a portion of the account value to be withdrawn without penalty, so if you need more money in addition to the immediate annuity payments, you can withdraw it from the deferred annuity.

For retirement plan income --Say your only retirement income is Social Security. You have savings but you're concerned that if you take out too much, you may run out too soon. The split annuity can provide a steady source of income without exhausting your principal. It's also flexible enough that if you need more income, you can take some from the fixed-interest deferred annuity (subject to early withdrawal penalties). At the end of the fixed income period, you can reevaluate your finances and determine whether you need more, less, or the same income, and adjust accordingly.

Bridge the gap between retirement and Social Security --You have some savings in the bank and you want to retire, but you don't want to (or are too young to) apply for Social Security retirement benefits. The income payments from the immediate annuity part of the split annuity concept may provide the income you want between retirement and Social Security. The fixed-interest deferred annuity preserves your principal by earning interest on the money you apportion to it. When you're ready to begin receiving Social Security retirement benefits, the fixed interest deferred annuity will have earned enough interest to equal your original principal investment.

The split annuity can help

With company pensions vanishing and the cost of living rising, you likely will have to rely on your own savings to provide the majority of your retirement income. The split annuity concept can be a useful part of your retirement income plan by supplying fixed income while preserving funds for later use.

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