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Annuitization: Single Versus Multiple Annuitants

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What is annuitization?

Annuitization is a payment option that turns the current value of an annuity into a stream of payments. When this option (also called the guaranteed income option) is selected, the annuity contract goes into payout mode.

Example(s): *Sally is 43 and is planning to retire when she turns 65. She purchases an annuity and makes annual premium payments of $3,000. For the next 22 years, the annuity accumulates tax-deferred income. When Sally turns 65, she chooses to annuitize. Sally stops making premium payments and starts receiving an annual payment of $8,000, which she will receive for the rest of her life. Note that this example is hypothetical--it does not reflect the actual performance of an annuity or the fees and charges associated with an annuity.*

Technical Note: *The annuitization phase is sometimes referred to as the payout period or benefit period.*

Note: The following sections discuss commercial annuities only. They do not include private annuities , which are contractual arrangements between private parties.

Who are the parties to any annuity contract?

There are generally four parties to an annuity contract: the issuer, the owner, the annuitant, and the beneficiary. The issuer is the issuing insurance company and is the party that accepts the premiums and promises to pay the benefits under the annuity contract. The owner is generally the purchaser of the annuity contract, the party who pays the premiums, and, usually, the party that receives the annuity payouts during the payout period. The annuitant provides the measuring life for the determination of the payouts to be paid. The beneficiary receives the remaining benefits, if any, at the death of the owner.

Typically, the owner and the annuitant are the same person.

How are annuity payments computed?

Annuity payments are computed using actuarial tables. These tables take into account the annuitant's life expectancy and interest earned. It's the annuitant whose life is of primary importance in determining the timing and amount of the payout. Thus, the annuitant's life is the "measuring life."

The tables are gender-based because women generally live longer. In the case of joint and survivor annuity options, an actuarial table containing both the annuitant's age and the designated survivor's age must be used to calculate the monthly payout.

Example(s): *Mr. Smith bought an annuity contract that now has an accumulation value of $50,000. He is now 65 and decides to begin receiving annuity payouts under a life-only settlement option. Using the actuarial tables, Mr. Smith receives a monthly payout in the amount of $334.*

Example(s): *Mr. Jones, by comparison, bought an annuity contract that now has a value of $50,000. He is now 75 and decides to begin receiving annuity payouts under a life-only settlement option. Using the actuarial tables, Mr. Jones receives a monthly payout in the amount of $471.*

Example(s): *Mr. Lucky bought an annuity that now has an accumulation value of $50,000. He is only 55 when he decides to take early retirement, after which he begins receiving annuity payouts under a life-only settlement option. Using the actuarial tables issued, Mr. Lucky receives a monthly payout in the amount of only $265. Note that this example is hypothetical--it does not reflect the actual performance of an annuity or the fees and charges associated with an annuity.*

Can there be more than one annuitant?

Typically, annuity contracts will have one annuitant, but this is not always the case. Some annuity contracts may allow multiple annuitants.

Can there be more than one recipient of annuity payouts?

Single annuities

An annuity that covers a single recipient of annuity payouts (usually the owner) is called a single life annuity, straight annuity, or straight life annuity. Benefits are paid to the recipient until the recipient dies. When the recipient dies, annuity payments stop. Following are some types of single annuities:

- Payments for life--This method provides the recipient with annuity payments for life only, and then they end. Annuity payments can be made monthly, quarterly, semi-annually, or annually. There is no designated beneficiary with this type of contract because the contract terminates at the owner's death.
- Payments for life with term certain--This method provides the recipient with annuity payments for life, and after the owner's death, the payments may continue to a named beneficiary if there is a period of time remaining on the original term certain. The term certain is generally 5, 10, 15, or 20 years.
- Payments for a specified period--This method provides the recipient with annuity payments for a specified period (generally 5, 10, 15, or 20 years). If the owner dies before the specified time period has elapsed, the remaining payments are received by a named beneficiary.
- Refund life -- This method provides the recipient with income for life, but if the owner dies before the total amount of the annuity payment is received, the balance is paid to a named beneficiary. The named beneficiary typically may receive the balance in a lump sum or in installments.

Joint and survivor annuity

A joint and survivor annuity provides two persons with income for life (first one, then the other, but not both at the same time). When one dies, the other continues to receive the annuity payouts (or some portion of them) for life.

A joint and survivor annuity can end at the death of the last person or after a certain number of payouts. Some contracts continue to pay the full income to the survivor (this is called a "joint and full to the survivor" policy). Some insurers offer annuity contracts that provide one-half or two-thirds of the income to the survivor after the first owner dies (these are called a "joint and one-half" policy or a "joint and two-thirds" policy, respectively). Typically, spouses purchase joint and survivor annuities, although nonspouses (e.g., elderly siblings) may purchase them as well.

What are the advantages of joint and survivor annuities?

Provides for more than one person

A joint and survivor annuity provides income during the joint lifetimes of the owner and a designated survivor (first one and then the other but not both at the same time). This may be advantageous if you want to provide for yourself and then someone else (e.g., your spouse) or if you want to provide for others (e.g., your children).

Joint and survivor may pay income for a longer time

Because a survivor annuity may pay until the death of the designated survivor, it generally pays for a longer period of time than a single policy (but see the disadvantages in the following section).

What are the disadvantages of joint and survivor annuities?

May be subject to estate tax

Joint and survivor annuities are included in the first owner's gross estate to the extent of the fair market value of the survivor's interest in the annuity.

May reduce monthly payments

A joint and survivor annuity will generally pay benefits over a longer period than a single annuity. Not surprisingly, because the benefits are expected to pay longer, monthly payments are lower.

How are annuity payouts treated for income tax purposes?

Each annuity payment is part nontaxable return of capital and part payment of accumulated income if the annuitization option is selected. Generally, only the portion of the payment that represents accumulated earnings on the contract is subject to income tax. To determine the amount of each annuity payment treated as nontaxable return of investment in the contract, divide the investment in the contract (i.e., premiums paid) by the expected return (i.e., premiums paid plus investment income) and multiply this amount by the amount of the annuity payment. For annuity contracts where the annuity starting date is after December 31, 1983, after the investment in the contract is fully recovered, all subsequent annuity payments are treated as coming entirely from taxable earnings.

Caution: *Annuity guarantees are subject to the claims-paying ability of the annuity issuer.*

To schedule an appointment with Faye Sykes, click [here](#) .

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